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In The

Supreme Court of the United States

October Term, 1997

BAUGHANS, INC.; BLUE EARTH ENTERPRISES, INC.; KEVIN BORES; CHARLES F. BUCK; DAVIS PIZZA ENTERPRISES, INC.; DIANE A. DAVIS; FISHER PIZZA, INC.; JAMES B. FISHER, JR.; JRW PIZZA, INC.; LUGENT PIZZA, INC.; JOSEPH J. LUGENT; SCALE PIZZA, INC.; SPRING GARDEN PIZZA, INC.; BRAD L. WALKER; JAMES R. WOOD; INTERNATIONAL FRANCHISE ADVISORY COUNCIL, INC.,

Petitioners,

v.

DOMINO'S PIZZA, INC.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

This case involves the derivative aftermarket in which franchisees of Domino's Pizza, Inc. ("Domino's") purchase the ingredients and supplies which they use to make Domino's brand pizza. Although the Domino's offering circular promised an aftermarket policed by price competition among several approved suppliers, Domino's acquired a 90% share of this aftermarket. Using that market power to obtain exclusive dealing arrangements with customers and requirements contracts from suppliers, Domino's changed its policy of approving alternate suppliers, and excluded a franchisee cooperative from competing with Domino's in this aftermarket. The franchisees' substantial investments in their franchises, coupled with noncompetition covenants, make switching to a different franchise financially impossible. Consequently, Domino's continues to reap supracompetitive profits on the sale of approved ingredients and supplies. The sharply divided Court of Appeals immunized these acts and affirmed the Rule 12(b)(6) dismissal of the franchisees' antitrust claim, which the District Court had entered without permitting any discovery at all.

This petition presents the following question:

Whether the derivative aftermarket for ingredients and supplies which the franchisees use to make the product sold in the franchised business format, may be a relevant market for analyzing under the antitrust laws the franchisor's willful acquisition and maintenance of a monopolistic share of that derivative aftermarket?

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF AUTHORITIES iv

OPINIONS AND ORDERS BELOW 1

JURSIDICTION 1

STATUTES INVOLVED 2

STATEMENT OF THE CASE 2

Statement of Facts 2

The Proceedings Below 6

REASONS FOR GRANTING THE WRIT 10

I. The Court of Appeals' decision is in conflict with antitrust precedent from other circuits in franchise tying and monopolization claims .. 10

II. The Third Circuit misapplied the legal and economic framework of *Kodak* 16

A. The Third Circuit misconstrued the economic underpinnings of *Kodak* 16

B. The Third Circuit ignored this Court's admonition to examine the facts and economic realities of each case and to avoid broad legal rules concerning the definition of relevant markets 19

C. The Third Circuit decision is in conflict with the Sixth and Seventh Circuits' interpretation of *Kodak* 21

TABLE OF CONTENTS – Continued

Page

III. The Court of Appeals' decision presents significant questions concerning the application of the antitrust laws to business format franchises, which compose a significant sector of the economy..... 24

CONCLUSION 27

TABLE OF AUTHORITIES

Page

CASES

Casey v. Diet Center, Inc., 590 F.Supp. 1561 (N.D. Cal. 1984) 12

Collins v. International Dairy Queen, Inc., 939 F.Supp. 875 (M.D. Ga. 1996) 8

Collins v. International Dairy Queen, Inc., ___ F.Supp. ___, 1997 WL 627504 (M.D. Ga. 1997) 15

Digital Equipment Corp. v. Uniq Digital Technologies, Inc., 73 F.3d 756 (7th Cir. 1996) 22

Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451 (1992) ..... *passim*

Grappone, Inc. v. Subaru of New England, Inc., 858 F.2d 792 (1st Cir. 1988) 14

Heatransfer Corp. v. Volkswagenwerk A.G., 553 F.2d 964 (5th Cir. 1977) 12, 24

Image Technical Services v. Eastman Kodak Co., 125 F.3d 1195, 1997 U.S. App. LEXIS 22608 (9th Cir. 1997) 9

International Boxing Club of New York, Inc. v. United States, 358 U.S. 242 (1959) 16

International Business Machines Corp. v. United States, 298 U.S. 131 (1936) 16

Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368 (5th Cir. 1977) 10

Krehl v. Baskin-Robbins Ice Cream Co., 664 F.2d 1348 (9th Cir. 1982) 7

Lee v. Life Ins. Co. of N. Am., 23 F.3d 14 (1st Cir. 1994) 23

Little Caesar Enterprises Co., Inc. v. Smith, Bus. Franchise Guide (CCH) ¶ 11 (E.D. Mich. 1996) 7

TABLE OF AUTHORITIES – Continued

Page

Metrix Warehouse, Inc. v. Daimler-Benz Aktiengeselleschaft, 828 F.2d 1033 (4th Cir. 1987) 11, 12, 13

Midwestern Waffles, Inc. v. Waffle House, Inc., 734 F.2d 705 (11th Cir. 1984) 11

Mozart Co. v. Mercedes-Benz of N. Am., 833 F.2d 1342 (9th Cir. 1987), *cert. denied*, 488 U.S. 870 (1988) 13, 14, 15

National Collegiate Athletic Ass'n v. Board of Regents of Univ. of Okla., 468 U.S. 85 (1984) 16

Northern v. McGraw-Edison Co., 542 F.2d 1336 (8th Cir. 1976), *cert. denied*, 429 U.S. 1097 (1976) 12

Perma Life Mufflers v. International Parts Corp., 392 U.S. 134 (1968) 10

Photovest Corp. v. Fotomat Corp., 606 F.2d 704 (7th Cir. 1979), *cert. denied*, 445 U.S. 917 (1980) 11

PSI Repair Services v. Honeywell, Inc., 104 F.3d 811 (6th Cir.), *cert. denied*, ___ U.S. ___, 117 S.Ct. 2434 (1997) 21

Redd v. Shell Oil Co., 524 F.2d 1054 (10th Cir. 1975) 7

Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971) 12

Standard Oil Co. v. United States, 337 U.S. 293 (1949) 10

Tominaga v. Shepherd, 682 F. Supp. 1489 (C.D. Cal. 1988) 12, 14

TABLE OF AUTHORITIES – Continued

Page

Valley Products Co., Inc. v. Landmark, 128 F.3d 398 (6th Cir. 1997) 15, 24

Virtual Maintenance, Inc. v. Prime Computer, Inc., 11 F.3d 660 (6th Cir. 1993) 24

Wilson v. Mobil Oil Corp., 940 F.Supp. 944 (E.D. La. 1996) 8

STATUTES

15 U.S.C. § 1 ..... 2, 6, 11

15 U.S.C. § 2 ..... 2, 6, 11

15 U.S.C. § 14 2

28 U.S.C. § 1254(1) 1

MISCELLANEOUS CITES

Areeda and Hovenkamp, ANTITRUST LAW ¶ 510 (1997 Supp.) 5

Baer, Lockerby, Wieczorek, *Domino's Pizza Delivers . . . a Blow to Franchisee Tying Claims*, 17 FRANCHISE L.J. 65 (1997) 5

Cantor, *Tying, Exclusive Dealing and Franchising Issues*, 890 P.L.I. 869 (1995) 6

Grimes, *When Do Franchisors Have Market Power? Antitrust Remedies For Franchisor Opportunism*, 65 ANTITRUST L.J. 105 (1996) 5, 8, 25

Guerin-Califert, *Assessing the Implications of Kodak for Franchise Market Power Issues, Assessing Market Power in the Post-Kodak World* (ABA Section of Antitrust Law Spring Meeting, March 27, 1996) 6

TABLE OF AUTHORITIES – Continued

Page

Hadfield, *Problematic Relations: Franchising and Law of Incomplete Contracts*, 42 STAN L. REV. 927 (1990) 24

Hovenkamp, *Market Power in Aftermarkets: Antitrust Policy in the Kodak Case*, 40 UCLA L.REV. 1447 (1993) 5, 18

Klein and Saft, *The Law and Economics of Franchise Tying Contracts*, 28 J. LAW & ECON. 345 (1985) 13

Lande, *Chicago Takes it on the Chin: Imperfect Information Could Play a Crucial Role In The Post-Kodak World*, 62 ANTITRUST L.J. 193 (1993) 14

Lazaroff, *Reflections On Eastman Kodak Co. v. Image Technical Services, Inc.: Continued Confusion Regarding Tying Arrangements and Antitrust Jurisprudence*, 69 WASH. L.REV. 101 (1994) 5

McDavid, *Kodak Decision Revitalizes Tying Claims*, 12 FRANCHISE L.J. 3 (1992) 5

Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 MICH. L.REV. 111 (1996) 5

Selden, *Franchise Market Power in a Post-Kodak Universe* (ABA Section of Antitrust Law Spring Meeting, March 17, 1996) 6

Silberman, *The Myths of Franchise "Market Power,"* ANTITRUST L.J. 181 (1996) 5

Solish, *A Survey of the Antitrust Consequences of Franchise Sourcing Limitations at the Millennium, Alive and Kicking: "Encroachment" and Tying Claims in Franchising*, 1 (ABA Section of Antitrust Law Annual Meeting, August 3, 1997) 8

TABLE OF AUTHORITIES – Continued

Page

Solish, *Market Power in Per Se Franchise Tying Claims: Virtual Maintenance Decision Addresses "Locked In" Buyers,* 13 FRANCHISE L.J. 73 (1994)..... 6

VonKalinowski, Sullivan and McGuirl, ANTITRUST LAWS AND TRADE REGULATION (1996) 20

OPINIONS AND ORDERS BELOW

The majority and dissenting opinions of the Court of Appeals are reported at 124 F.3d 430 (3d Cir. 1997), and reprinted at Petitioner's Appendix ("Pet. App.") 1. The order of the Court of Appeals denying Petitioners' ("Franchisees' ") petition for rehearing and suggestion for rehearing *en banc*, and the opinion for the five judges who would have granted rehearing, is reported at 129 F.3d 724 (3d Cir. 1997), and is reprinted at Pet. App. 46. The order of the United States District Court for the Eastern District of Pennsylvania granting Respondent Domino's Pizza, Inc.'s ("Domino's") motion to dismiss pursuant to Rule 12(b)(6) is published at 922 F. Supp. 1055 (E.D. Pa. 1996), and is reprinted at Pet. App. 51. The opinion of the District Court denying Plaintiffs' motion to file an amended complaint is not reported and is reprinted at Pet. App. 70.[1]

JURISDICTION

The Court of Appeals entered judgment on August 27, 1997. It denied a timely petition for rehearing and suggestion for rehearing *en banc* on October 27, 1997. This Court has jurisdiction to review the judgment by writ of certiorari under 28 U.S.C. § 1254(1).

[1] Pursuant to Supreme Court Rule 29.6, Petitioners state that none of the incorporated Petitioners has a parent or subsidiary corporation.

STATUTES INVOLVED

The statutory provisions involved are Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1-2, and Section 3 of the Clayton Act, 15 U.S.C. § 14. (reprinted in full at Pet. App. 167).

STATEMENT OF THE CASE

The sharply divided Court of Appeals held, as a matter of law, that franchisors are wholly immune from antitrust liability where the victims of their monopolistic behavior are the franchisor's own franchisees. With the panel divided 2-1, and the full Court divided 7-5, the Court affirmed a Rule 12(b)(6) dismissal of the Franchisees' well pleaded antitrust claims, immunizing from antitrust scrutiny a section of the economy which the panel acknowledged encompasses more "than one-third of all dollars spent in retailing transactions in the United States. . . . " 124 F.3d at 441, Pet. App. 23. As the dissent cogently demonstrated, Pet. App. 33-45, the Rule 12(b)(6) dismissal reflects a misunderstanding and misapplication of this Court's opinion in *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 541 (1992), and conflicts with several decisions of other Courts of Appeals that franchisees' antitrust claims against their franchisors do state a claim for which relief may be granted.

Statement of Facts

This case involves the $500,000,000 per year market in which Domino's franchisees purchase the ingredients

which they use to make Domino's brand pizza, which they sell in the business format franchised by Domino's. Domino's has 100% of the market for fresh dough bought by the franchisees and 90% of the market for other ingredients and supplies bought by the franchisees ("Ingredients and Supplies"). Except for fresh dough, Domino's does not manufacture those Ingredients and Supplies. Rather, Domino's buys the Ingredients and Supplies from approved suppliers, and then resells them to the franchisees at a marked up price. Pet. App. 5.

In an effort to bring price competition to this aftermarket, the association of Domino's franchisees approached a franchisee cooperative to enter the market in competition with Domino's. This franchisee cooperative was already successfully competing, for example, with PepsiCo Foodservice selling ingredients and supplies to Kentucky Fried Chicken franchisees and Taco Bell franchisees. Pet. App. 86.

Domino's did not disapprove the franchisee cooperative as a competing supplier. Rather, Domino's responded to this potential competition with the classic market manipulations of a monopolist, using its market power to force the franchisee cooperative out of the market for Ingredients and Supplies.

Using its 90% share of the $500,000,000 Ingredients and Supplies aftermarket – not its contractual approval prerogatives – Domino's offered predatory, discriminatory rebates to its largest franchisees to induce them to enter into exclusive dealing arrangements with Domino's, thereby foreclosing them as potential customers of the franchisee cooperative. Pet. App. 91-96. Domino's also

used its market power to coerce the sole supplier of ready-made parbaked dough, the primary supplier of thin-crust shells, and all the suppliers of sauce, to contract to sell their entire output to Domino's, thereby foreclosing the franchisee cooperative from access to the essential ingredients it would need to enter the market for distributing Ingredients and Supplies to franchisees. Pet. App. 91-93.

By these willful uses of its monopolistic share of the aftermarket for Ingredients and Supplies – not merely its contractual power to approve the suppliers – Domino's has excluded the franchisee cooperative from competing in that market. By foreclosing interbrand competition in the aftermarket for Ingredients and Supplies, Domino's has reaped supracompetitive profits in that market. Pet. App. 102-03.

These market conditions are in marked contrast to what Domino's promised the Franchisees when they purchased their franchises. Domino's promised the Franchisees an aftermarket policed by price competition. In the premarket in which the Franchisees purchased their franchises, the Domino's Offering Circular indicated that it would approve several sources of Ingredients and Supplies, thereby insuring price competition in this aftermarket. Pet. App. 82. After the Franchisees purchased their franchises, Domino's failed to adhere to this representation, and erected barriers to entry by potentially competing suppliers of Ingredients and Supplies. Those barriers to entry enabled Domino's to gain a 90% share of this aftermarket. Domino's then used the market power arising from its 90% market share – not merely its contractual prerogatives – to raise prices and exclude competition in this market. Pet. App. 87-99.

The Franchisees are economically locked in to their franchises not only by their substantial monetary investments, but also by substantial restrictions on their ability to sell their franchises and noncompetition covenants which preclude the Franchisees from purchasing a competitor's fast food franchise. Pet. App. 152-54. These information costs, sunk costs and switching costs preclude the Franchisees from responding to Domino's market manipulations by returning to the premarket in which fast food franchises are sold. The Franchisees are locked into the aftermarket, which therefore is the relevant market for antitrust analysis of Domino's restraints of trade.[2]

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[2] The decision in this case to immunize the franchisor-franchisee relationship from antitrust scrutiny, despite this Court's economic analysis of locked in aftermarkets in *Kodak*, is an issue which permeates current antitrust commentary:

> The debate among courts and commentators as to whether the Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451 (1992), breathed new life into franchise tying claims has, at times, had all the back and forth characteristics of a tennis match.

Baer, Lockerby, Wieczorek, *Domino's Pizza Delivers . . . a Blow to Franchisee Tying Claims*, 17 FRANCHISE L.J. 65 (1997). *See e.g.*, Areeda and Hovenkamp, ANTITRUST LAW ¶ 510 (1997 Supp.); Grimes, *When Do Franchisors Have Market Power? Antitrust Remedies for Franchisor Opportunism*, 65 ANTITRUST L.J. 105 (1996); Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 MICH. L.REV. 111 (1996); Silberman, *The Myths of Franchise "Market Power,"* 65 ANTITRUST L.J. 181 (1996); Lazaroff, *Reflections On Eastman Kodak Co. v. Image Technical Services, Inc.: Continued Confusion Regarding Tying Arrangements and Antitrust Jurisprudence*, 69 WASH. L.REV. 101 (1994); Hovenkamp, *Market Power in Aftermarkets: Antitrust Policy in the Kodak Case*, 40 UCLA L.REV. 1447 (1993); McDavid,

Those allegations – which must be assumed to be true in the Rule 12(b)(6) posture of this case – formed the crux of the Complaint that was dismissed without any discovery being permitted.

The Proceedings Below

Based upon the foregoing factual allegations – which are assumed to be true when reviewing a dismissal for failure to state a claim – the Franchisees pleaded that Domino's has willfully acquired the power to increase prices and exclude competition in the market for Ingredients and Supplies, and that it has willfully maintained and used that monopoly power in that market, in violation of Section 2 of the Sherman Act. Pet. App. 103.[3]

Kodak Decision Revitalizes Tying Claims, 12 FRANCHISE L.J. 3 (1992); Solish, *Market Power in Per Se Franchise Tying Claims: Virtual Maintenance Decision Addresses "Locked in" Buyers*, 13 FRANCHISE L.J. 73 (1994); Solish, *A Survey of the Antitrust Consequences of Franchise Sourcing Limitations at the Millennium, Alive and Kicking: "Encroachment" and Tying Claims in Franchising*, 1 (ABA Section of Antitrust Law Annual Meeting, August 3, 1997); Cantor, *Tying, Exclusive Dealing and Franchising Issues*, 890 PLI 869 (1995); Selden, *Franchise Market Power in a Post-Kodak Universe* (ABA Section of Antitrust Law Spring Meeting, March 17, 1996); Guerin-Califert, *Assessing the Implications of Kodak for Franchise Market Power Issues, Assessing Market Power in the Post-Kodak World*, 1 (ABA Section of Antitrust Law Spring Meeting, March 27, 1996).

[3] The Franchisees also pleaded that, after they acquired their Domino's franchises, Domino's imposed two separate unlawful tie-in arrangements in violation of Section 1 of the Sherman Act and Section 3 of the Clayton Act: (1) requiring Franchisees to buy Ingredients and Supplies from Domino's as a condition to being able to acquire fresh dough from Domino's

Refusing to permit any discovery at all, the District Court dismissed the Franchisees' complaint for failure to state a claim under Rule 12(b)(6). 922 F. Supp. at 1064, Pet. App. 69. The District Court held, as a matter of law, that a derivative aftermarket in which a business format franchisee buys Ingredients and Supplies which the franchisee uses to make the finished product, can never be a relevant market for antitrust purposes, under any set of facts.[4] The District Court held, as a matter of law, that competition in the premarket for franchises inherently polices the aftermarket for Ingredients and Supplies, and that a franchisor's abuse of power in the aftermarket is therefore only a concern of contract law, and is never a concern of antitrust law. Disregarding this Court's rejection of the same, formalistic economic analysis in *Kodak*, the District Court held that the relevant market is always

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and (2) requiring Franchisees to buy Ingredients and Supplies from Domino's as a condition to continuing as a Domino's franchisee. Pet. App. 104. The District Court had original subject matter jurisdiction under 28 U.S.C. § 1331.

[4] A business format franchise, such as Domino's, is different from a franchised distributor of finished products manufactured by the franchisor, such as Baskin-Robbins. In a business format franchise, the franchisee pays a fee for a method of doing business, not a product to be resold; it is the franchisees who are responsible for the production and preparation of the product sold in connection with the franchised trademark. Accordingly, it is business format franchisees who purchase goods in the kind of derivative aftermarket at issue in this case. *See Redd v. Shell Oil Co.*, 524 F.2d 1054, 1056-57 (10th Cir. 1975). *Compare Little Caesar Enterprises Co., Inc. v. Smith*, Bus. Franchise Guide (CCH) ¶ 11, 163 (E.D. Mich. 1996), *with Krehl v. Baskin-Robbins Ice Cream Co.*, 664 F.2d 1348 (9th Cir. 1982).

the premarket in which the franchise is purchased, never the aftermarket in which the Ingredients and Supplies are purchased. 922 F. Supp. at 1062, Pet. App. 64. The District Court's brightline test, and its misapprehension of this Court's antitrust analysis in *Kodak*, was rejected by other courts[5] and criticized by the commentators.[6]

Without adopting the premarket vs. aftermarket dichotomy on which the District Court's judgment was premised, the Court of Appeals nevertheless affirmed, 2-1. The majority held that in no circumstances could a franchise derivative aftermarket be a relevant antitrust market. The majority reasoned that the absence of cross-elasticity of demand between approved and nonapproved Ingredients and Supplies results solely from Domino's contractual approval prerogatives, and that the relevant market therefore is the premarket in which the Franchisees purchased their franchises. The majority rejected the Franchisees' contention that the derivative franchise aftermarket was consistent with this Court's decision in *Kodak*. Rather than reading *Kodak* as premised upon the substantial economic lock-in experienced by Kodak copier owners in that case, and Kodak's change in policy after the

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[5] *Wilson v. Mobil Oil Corp.*, 940 F.Supp. 944 (E.D. La. 1996); *Collins v. International Dairy Queen, Inc.*, 939 F.Supp. 875 (M.D. Ga. 1996) ("This Court declines to accept the view of the *Queen City* court").

[6] *See, e.g.*, Grimes, *When Do Franchisors Have Market Power? Antitrust Remedies For Franchisor Opportunism*, 65 ANTITRUST L.J. 105 (1996); Solish, *A Survey of the Antitrust Consequences of Franchise Sourcing Limitations at the Millennium, Alive and Kicking: "Encroachment" and Tying Claims in Franchising* 1 (ABA Section of Antitrust Law Annual Meeting, August 3, 1997).

copier owners made their investment, the majority held that *Kodak* turned on the uniqueness of Kodak spare parts. In the majority's view, *Kodak* was therefore inapplicable to the Franchisees' claim since the Ingredients and Supplies were not physically unique from other pizza ingredients and supplies. In the majority's view, the degree to which the Franchisees are locked into their franchise by the information costs, sunk costs and switching costs is irrelevant to the proper application of *Kodak*.

Judge Lay's dissent correctly read *Kodak* as turning on the economic lock-in, which clearly applied to Domino's change in policy after the Franchisees made substantial investments in franchises they could not easily sell. "Whether the product is unique was not the key component of the *Kodak* opinion." 124 F.3d at 447, Pet. App. 39[7]. Judge Lay also recognized that the District Court and the panel majority rested their decision on pre-*Kodak* case law and commentary that was "simply irreconcilable with the Supreme Court's analysis of information and switching costs in *Kodak*." 124 F.3d at 445 n.1, Pet. App. 34.

By a vote of 7-5, the Court of Appeals denied the Franchisees' petition for rehearing. Dissenting from the denial of rehearing, Judge Becker echoed the analysis in Judge Lay's dissent, emphasizing that the panel's interpretation of *Kodak* would mean "that the franchisor/franchisee relationship is virtually rendered immune from

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[7] Indeed, the branded parts at issue in *Kodak* were "unique" only because Kodak's contracts with third party suppliers prevented sales of the parts to anyone but Kodak. *See Image Technical Services, Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1997 U.S. App. LEXIS 22608, *3-4 (9th Cir. 1997).

antitrust scrutiny." 129 F.3d 724, Pet. App. 48. Criticizing the majority for resolving factual disputes on a motion to dismiss, Judge Becker said: "even if the majority's legal position is correct, it can only be sustained if it were an affirmance of a summary judgment on a full record, which is how the opinion seems to read. It cannot stand under its actual procedural status – review of a Rule 12(b)(6) dismissal." 129 F.3d at ___, Pet. App. 50.

REASONS FOR GRANTING THE WRIT

I. The Court of Appeals' decision is in conflict with antitrust precedent from other circuits in franchise tying and monopolization claims.

As the dissenting opinions recognized, antitrust has long been concerned with franchisors' abuse of their economic power in franchisee aftermarkets, perhaps because too many franchisors have been unable to resist the temptation to monopolize these captive markets. 124 F.3d at 449, Pet. App. 44-45. *See, e.g., Standard Oil Co. v. United States*, 337 U.S. 293 (1949); *Perma Life Mufflers v. International Parts Corp.*, 392 U.S. 134 (1968). In *Standard Oil*, this Court squarely held that otherwise anticompetitive tying arrangements are not justified by the franchisor's ostensible need to control quality unless they are the least restrictive alternative available.[8]

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[8] *Accord Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.*, 549 F.2d 368, 376 (5th Cir. 1977) ("The franchisor is free to demonstrate that the tie constitutes a necessary device for controlling the quality of the end product sold to the consuming public. As part of this defense, however, the franchisor must

For decades, the Courts of Appeals uniformly applied these precedents to franchisor tying arrangements, explicitly recognizing the derivative aftermarket as the relevant market for analyzing franchisor tying arrangements under Section 1 and franchisor monopolization claims under Section 2. For example, in *Metrix Warehouse, Inc. v. Daimler-Benz Aktiengeselleschaft*, 828 F.2d 1033, 1036-39 (4th Cir. 1987), the Fourth Circuit recognized a relevant aftermarket in Mercedes-Benz brand replacement parts. Affirming a jury verdict for the franchised dealer, the Fourth Circuit squarely held that the franchisor's use of its contractual powers to compel the franchisee dealers to purchase only replacement parts manufactured by Mercedes-Benz constituted an illegal tying arrangement under the Sherman Act, 828 F.2d at 1040-42.

The Fourth Circuit held that the franchisor's business justification for requiring franchisees to use only "genuine" replacement parts, and the business justification for the franchisor's refusal to permit its franchisees to purchase replacement parts from independent suppliers, presented a question of fact for the trier of fact. The Fourth Circuit's decision in *Metrix* echoes decisions of the Fifth, Seventh and Eighth Circuits.[9]

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establish that the tie constitutes the method of maintaining quality that imposes the least burden on commerce. If there are less burdensome alternatives, a franchisor is obligated to employ them rather than the tie"). *See also Midwestern Waffles, Inc. v. Waffle House, Inc.*, 734 F.2d 705, 712-13 (11th Cir. 1984).

[9] In *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704, 721-24 (7th Cir. 1979), *cert. denied*, 445 U.S. 917 (1980), the Seventh Circuit recognized a derivative aftermarket in the franchisor's photo processing services, holding that the franchisor's use of

The Third Circuit's decision in this case is in direct conflict with the Fourth Circuit's decision in *Metrix*. The Third Circuit created a rule of *per se* legality for the franchisor's quality control claims. The majority held that Domino's approval prerogatives are essential to "prevent franchisees from free riding – offering products of sub-standard quality insufficient to maintain the reputational value of the franchise product while benefiting from the

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its contractual approval powers to compel the franchisees to purchase Fotomat processing services from Fotomat as a condition of retaining their franchise constituted an unlawful tying arrangement. 606 F.2d at 721-24. In *Heatransfer Corp. v. Volkswagenwerk A.G.*, 553 F.2d 964, 979-81 (5th Cir. 1977), the Fifth Circuit recognized a relevant antitrust market in air conditioners that could be installed only in Volkswagen automobiles. Affirming a jury verdict for an independent supplier of automobile air conditioners, the Fifth Circuit squarely held that Volkswagen's requirement that its franchised dealers buy only air conditioners manufactured by Volkswagen constituted an illegal tying arrangement and monopolization of the derivative aftermarket. *Accord Northern v. McGraw-Edison Co.*, 542 F.2d 1336, 1345 (8th Cir. 1976), *cert. denied*, 429 U.S. 1097 (1976) (Arnold Palmer dry cleaning franchisor's use of its contractual approval powers to compel the franchisees to purchase franchisor's dry cleaning equipment constitutes an unlawful tie-in arrangement). *See also Siegel v. Chicken Delight, Inc.*, 448 F.2d 43 (9th Cir. 1971) (contractual requirement by a fast food franchisor that its franchisees purchase equipment and supplies from the franchisor held to constitute an illegal tie-in arrangement). The decision in *Chicken Delight* was criticized for attributing to the franchised trademark the kind of economic power ordinarily inferred from patents and copyrights. *See Tominaga v. Shepherd*, 682 F. Supp. 1489, 1493-95 (C.D. Cal. 1988); *Casey v. Diet Center, Inc.*, 590 F. Supp. 1561, 1564-66 (N.D. Cal. 1984). However, the other cited cases did not rely on that rationale. Moreover, in this case, the Franchisees have relied exclusively upon *Kodak's* analysis of aftermarket lock-ins.

quality control efforts of other actors in the franchise system." 124 F.3d at 440-41; Pet. App. 23. Ironically, the majority also held that *Kodak's* aftermarket analysis is inapplicable to this case because the ingredients approved for use in making Domino's pizza are not sufficiently "unique" to invoke the *Kodak* analysis. The majority opinion would thus establish an anomalous precedent which immunizes franchisor "quality control" restrictions where they are least warranted.

The decisions of the Fourth, Fifth, Seventh and Eighth Circuits were criticized by devotees of the Chicago School of antitrust analysis, who argued that competition in the premarket for franchises should adequately police the franchisor's power in the derivative aftermarket. *See, e.g.,* Klein and Saft, *The Law and Economics of Franchise Tying Contracts,* 28 J. LAW & ECON. 345 (1985). In this theoretical economic model, the relevant antitrust market should always be the premarket in which franchises are sold, and never the derivative aftermarket for the equipment, ingredients and supplies used by business format franchisees.

In *Mozart Co. v. Mercedes-Benz of N. Am.*, 833 F.2d 1342 (9th Cir. 1987), *cert. denied*, 488 U.S. 870 (1988), the Ninth Circuit adopted the Klein and Saft economic model, and expressly rejected the precedents from the other circuits. The Ninth Circuit's decision involved the identical issue decided by the Fourth Circuit in *Metrix:* whether Mercedes-Benz's restrictions on replacement parts is an illegal tying arrangement. Since Mercedes-Benz did not have a substantial share of the premarket for franchises to sell automobiles, the Ninth Circuit held the franchisees failed to state a tying claim. *Id.* at 1345-47. *Mozart* was followed

by *Tominaga v. Shepherd*, 682 F. Supp. 1489 (C.D. Cal. 1988) which applied Klein and Saft's theory to a fast food franchisee's tying claim. *Id.* at 1493-95. Both courts expressly acknowledged their decisions were in direct conflict with prior case law. *See Mozart*, 833 F.2d at 1346 & n.4; *Tominaga*, 682 F. Supp. at 1494-95.[10]

However, the notion that competition in the premarket always adequately polices anticompetitive behavior in the aftermarket was expressly rejected by this Court in *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 541 (1992). *See* Lande, *Chicago Takes it on the Chin: Imperfect Information Could Play a Crucial Role In The Post-Kodak World*, 62 ANTITRUST L.J. 193 (1993).

In *Kodak*, independent service organization ("ISOs") offered service to Kodak copier and micrographics owners. In order to perform this service, ISOs needed replacement parts, some of which were only available from suppliers approved by Kodak. In a change of policy, *Kodak* refused to permit its suppliers to sell replacement parts to the ISOs, and permitted them to sell parts only to copier owners who contracted with Kodak for service. This policy was implemented only after the Kodak owners made their initial investments in the durable goods. *Id.* at 456-58.

The trial court granted Kodak summary judgment on the ISOs antitrust claims, but the Ninth Circuit reversed, stating that the ISOs had defined a relevant aftermarket

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[10] *See also Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792 (1st Cir. 1988).

in Kodak's own goods that withstood summary judgment. *Id.* at 459-61. This Court affirmed the Ninth Circuit, holding that Kodak's unilateral change in policy, coupled with switching and informational costs, created a genuine issue of material fact whether the aftermarket in Kodak parts and service was the relevant market. *Id.* at 477-78, 481-86. Clearly, *Kodak* vitiated *Mozart's* rationale.

The Third Circuit's decision in this case is in direct conflict with both *Kodak* and the decisions of the Fourth, Fifth, Seventh and Eighth Circuits. Rejecting those precedents, the Third Circuit chose to adopt the Ninth Circuit's rationale in *Mozart*, which expressly acknowledged its conflict with the decisions of other circuits. 833 F.2d at 1346 n.4. *See also Valley Products Co., Inc. v. Landmark*, 128 F.3d 398, 405-07 (6th Cir. 1997) (noting conflict between Third Circuit's decision in this case and prior decisions of other circuits). At least one District Court has expressly refused to follow the decision of the Third Circuit. *Collins v. International Dairy Queen, Inc.*, ___ F. Supp. ___, 1997 WL 627504 (M.D. Ga. 1997).

The Ninth Circuit's decision in *Mozart* predates *Kodak* and therefore contains no analysis of the information costs, sunk costs and switching costs which are essential to determining whether the economic lock-in of the franchisee makes the derivative aftermarket a relevant antitrust market. Under *Kodak*, the franchisee derivative aftermarket recognized by the Fourth, Fifth, Seventh and Eighth Circuits may be the relevant antitrust market, depending upon the facts of the case. That determination is for the trier of fact, not a Rule 12(b)(6) dismissal. The Third Circuit's reliance on *Mozart*, and its holding that

the aftermarket may never be the relevant market, under any set of facts, clearly conflict with *Kodak*.

This Court should grant the writ in order to resolve this clear and acknowledged conflict in this circuits, which relates to the proper application of the antitrust laws to a significant sector of the American economy.

II. The Third Circuit misapplied the legal and economic framework of *Kodak*.

A. The Third Circuit misconstrued the economic underpinnings of *Kodak*.

In *Kodak*, this Court specifically approved a relevant market defined as an aftermarket derived from one manufacturer's products, as distinguished from the premarket for the primary product from which the aftermarket is derived. 504 U.S. at 477-79.[11] In *Kodak*, this Court emphasized the economic realities of market behavior, holding that significant switching costs, coupled with information imperfections, can make a derivative aftermarket the relevant market for antitrust analysis.

The factual situation of copier owners in *Kodak* is plainly parallel to the situation of the Franchisees in this

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[11] *Kodak* noted that prior decisions of this Court have recognized relevant markets in a single brand. 504 U.S. at 482 (citing *National Collegiate Athletic Ass'n v. Board of Regents of Univ. of Okla.*, 468 U.S. 85, 101-02, 111-12 (1984); *International Boxing Club of New York, Inc. v. United States*, 358 U.S. 242, 249-52 (1959); *International Business Machines Corp. v. United States*, 298 U.S. 131 (1936)

case. Indeed, the relevant market realities are identical. As the dissent recognized, the Franchisees' substantial investments, Domino's fraudulent misrepresentation of effective aftermarket competition and the noncompetition covenants which exact prohibitive switching costs, combine to insulate the aftermarket from the competition in the premarket for franchises. Accordingly, the question whether the aftermarket is the relevant antitrust market is, under *Kodak*, a question of fact for the trier of fact.

The Third Circuit majority nevertheless applied a bright line test and held the derivative franchisee aftermarket may never be a relevant antitrust market, under any set of facts. The majority's errors arise from the fundamental misperception that *Kodak* rested primarily on the "uniqueness" of the Kodak parts. 124 F.3d at 439-40, Pet. App. 16-21. But *Kodak* did not hold the uniqueness of spare parts was dispositive. Instead, the Court emphasized the effect of Kodak's change in policy combined with the lock-in effect of purchasers' sunk costs:

> It is . . . plausible . . . to infer that Kodak chose to gain immediate profits by exerting that market power where locked-in customers, high information costs, and discriminatory pricing limited and perhaps eliminated any long term loss. Viewing the evidence in the light most favorable to respondents, their allegations of market power "mak[e] . . . economic sense."

504 U.S. at 477-78 (citations omitted).[12] Because *Kodak* customers did not reasonably anticipate the change in

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[12] The Third Circuit majority's reliance upon the ostensible uniqueness of the Kodak replacement parts is the mistaken application of *Kodak* predicted by the dissent in that case. As the *Kodak* dissent stated, recognizing aftermarkets based solely on

policy, it made "economic sense" to recognize aftermarkets in parts and service. Domino's fraudulent misrepresentation, combined with the Franchisees' sunk costs and switching costs, is squarely within *Kodak's* analysis. As the dissent said:

> [T]he Supreme Court's clear direction in *Kodak* [is] that information and switching costs are relevant to the ultimate determination of market power. . . . The reality of the aftermarket for

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unique products or supplies would potentially subject every equipment and parts manufacturer or supplier to antitrust claims based on an aftermarket whenever that manufacturer or supplier refused to sell to a willing buyer. *See* 504 U.S. at 493 ("I find this a curious form of market power on which to premise the application of a *per se* proscription. It is enjoyed by virtually every manufacturer of durable goods requiring aftermarket support with unique, or relatively unique, goods.") (Scalia, J., dissenting). *See also* Hovenkamp, *Market Power in Aftermarkets: Antitrust Policy in the Kodak Case*, 40 UCLA L.Rev. 1447, 1454-55 (1993). Furthermore, approved ingredients are not interchangeable with nonapproved ingredients for the same reason that *Kodak* authorized service was not reasonably interchangeable with independent photocopier service. *Kodak* does not manufacture replacement parts, and Domino's does not manufacture ingredients; they are manufactured for them by third parties. The only reason independent service organizations could not obtain parts for Kodak copiers was that Kodak contractually required the manufacturers of the replacement parts to refuse to deal with the independent service organizations. Similarly, the only reason the Franchisees cannot obtain the nonapproved ingredients is that Domino's refuses to approve those manufacturers' products for use by its Franchisees, despite the majority's presumption that those manufacturers' ingredients meet all of Domino's quality specifications and are therefore interchangeable with the approved ingredients.

> ingredients and supplies faced by these plaintiffs, according to the pleadings, is that alternative suppliers do not restrain DPI's ability to increase price, and information and switching costs lock-in the franchises thereby preventing any competitive response to the price increases from DPI.

124 F.3d at 449 (Lay, J., dissenting), Pet. App. 45. Therefore, the Third Circuit's distinction between the unique parts in Kodak and the allegedly fungible ingredients in this case, is not a meaningful distinction, especially in light of this Court's admonition that "[t]he proper market definition . . . can be determined only after a factual inquiry into the 'commercial realities' faced by consumers." 504 U.S. at 482 (citation omitted). If the ingredients approved by Domino's were fungible with nonapproved ingredients, Domino's would have no basis for withholding its approval. The reality is that the Franchisees are at least as locked-in as the photocopier purchasers in *Kodak*, so that a derivative aftermarket is the relevant market in this case.

B. The Third Circuit ignored this Court's admonition to examine the facts and economic realities of each case and to avoid broad legal rules concerning the definition of relevant markets.

In *Kodak*, this Court recognized that antitrust cases are fact-intensive, and are therefore not good candidates for resolution on summary judgment, much less on a Rule 12(b)(6) motion, based on economic presumptions concerning the functioning of the market:

> Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law. This Court has preferred to resolve antitrust claims on a case-by-case basis, focusing on the "particular facts disclosed by the record." In determining the existence of market power, and specifically the "responsiveness of the sales of one product to price changes of the other," this Court has examined closely the economic reality of the market of issue.

504 U.S. at 466-67 (citations omitted). Consequently, economic theory is a useful tool to evaluate antitrust claims, but cannot be the end of the inquiry into how markets in fact behave.

Instead of ruling on a full record, the Third Circuit created a rule of *per se* legality with no consideration of economic reality. According to the panel, if it were "to accept Plaintiffs' relevant market, virtually all franchise tying agreements requiring the franchisee to purchase inputs such as ingredients and supplies from the franchisor would violate antitrust law." 124 F.3d at 440, Pet. App. 23. Even if this were a legitimate concern for the courts instead of Congress[13], years of applying the Sherman Act to franchise relationships show that the panel's

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[13] To the extent that Congress has spoken, its statutory language encourages instead of discourages application of the antitrust laws to franchisor-franchisee dealings: "Section 3 of the Clayton Act was designed specifically to prohibit restrictive methods of competition which prevent a buyer or lessee from dealing in the goods of his seller's or lessor's competitors." 16A VonKalinowski, Sullivan and McGuirl, ANTITRUST LAWS AND TRADE REGULATION § 66.03[1] (1996).

concern about the "chilling effect" on the franchise format is wholly misguided. Recognizing and applying the logic of *Kodak* simply means that a franchisor is subject to antitrust liability where its actions create information and switching costs such that the market cannot respond to supracompetitive pricing or other anticompetitive conditions.

C. The Third Circuit decision is in conflict with the Sixth and Seventh Circuits' interpretation of *Kodak*.

The Third Circuit's decision explicitly limited *Kodak* to markets involving "physically unique" products, completely discounting the roles of information costs, sunk costs and switching costs that create an economic lock-in. *See* 124 F.3d at 439-40, Pet. App. 20-21. This interpretation of *Kodak* is in direct conflict with the Sixth Circuit's application of *Kodak* in *PSI Repair Services v. Honeywell, Inc.*, 104 F.3d 811 (6th Cir.), *cert. denied*, ___ U.S. ___, 117 S.Ct. 2434 (1997).

In that case, the plaintiff, PSI, was an independent computer repair service that desired to service Honeywell-brand circuit boards. Defendant Honeywell did not manufacture its own board components, but had restrictive agreements with the manufacturers who made components specific to Honeywell boards. In addition, Honeywell offered to replace any defective or worn-out boards for 50% of the list price, if the consumer would return the boards to Honeywell. These policies served to

insure that PSI and other independent service organizations could not get enough spare board parts to offer service on Honeywell boards. *Id.* at 813-14.

Analyzing *Kodak*, the Sixth Circuit stated that: "the change in policy in *Kodak* was the crucial factor in the Court's decision." *Id.* at 820. When information is expensive or otherwise difficult to obtain, unexpected changes in policy could not have been evaluated by the consumer when determining whether to enter the initial transaction in the premarket. In the view of the Sixth Circuit,

> [b]y changing its policy after its customers were "locked in," . . . [Kodak] took advantage of the fact that its customers lacked the information to anticipate this change. Therefore, it was Kodak's own actions that increased its customers' information costs. In our view, this was the evil condemned by the Court and the reason for the Court's extensive discussion of information costs.

Id. PSI's claim failed because there was no change in policy. Honeywell's parts policy was well-known at the time of manufacture and sale.

Similarly, the Seventh Circuit held that Kodak's change in policy is the key to this Court's antitrust analysis. *Digital Equipment Corp. v. Uniq Digital Technologies, Inc.*, 73 F.3d 756 (7th Cir. 1996). In that case, Judge Easterbrook held that "[t]he material dispute that called for a trial [in *Kodak*] was whether the change in policy enabled

Kodak to extract supracompetitive prices from customers who had already purchased its machines." *Id.* at 763.[14]

The Third Circuit's interpretation of *Kodak* directly conflicts with the Sixth and Seventh Circuit's recognition that *Kodak's* change in policy is the key to the decision in that case. The Third Circuit explicitly limited *Kodak* to derivative aftermarkets in "unique" parts, and completely discounted this Court's analysis concerning the information and switching costs that create an economic lock-in: "*Kodak* does not hold that the existence of information and switching costs alone, such as those faced by the Domino's franchisees, renders an otherwise invalid relevant market valid." 124 F.3d at 439, Pet. App. 20.

But Domino's changed its policy at least as much as Kodak changed its policy. For purposes of the motion to dismiss, it is presumed true that the Domino's Offering Circular promised to approve an adequate number of suppliers to ensure price competition in the aftermarket for Ingredients and Supplies, and it is presumed true that Domino's failed to adhere to that policy after the Franchisees were locked into their franchises. The Third Circuit decision therefore directly conflicts with the Sixth

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[14] *Accord Lee v. Life Ins. Co. of N. Am.*, 23 F.3d 14 (1st Cir. 1994). In that case, the First Circuit declined to apply *Kodak* to a group of University of Rhode Island students' claim that URI had impermissibly tied an education at URI to the purchase of University health services. The court refused to apply *Kodak* on the grounds that the "tie" was fully disclosed at the time the students "purchased" their educations (i.e., paid their tuition), and that there was no appreciable long-term lock-in since students were free to leave at the end of any semester. *Id.* at 17-20.

and Seventh Circuit's interpretation of *Kodak's* analysis of derivative aftermarkets.[15]

III. The Court of Appeals' decision presents significant questions concerning the application of the antitrust laws to business format franchises, which compose a significant sector of the economy.

The Court of Appeals held, as a matter of law, that the aftermarket for Ingredients and Supplies, which these business format Franchisees are locked into, can never be the relevant market in which to analyze the antitrust implications of the franchisor's monopolistic behavior in that market. The Court of Appeals created a rule of *per se* legality for franchisor abuses, and held that a franchisee's only remedy is for breach of the franchise contract.[16]

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[15] *See also Virtual Maintenance, Inc. v. Prime Computer, Inc.*, 11 F.3d 660, 663 (6th Cir. 1993). (*Kodak* held summary judgement improper where plaintiffs proof showed "information and switching costs," and "that certain parts were available exclusively through Kodak, that Kodak had control over the availability of parts it didn't manufacture, and that Kodak's control over its parts market had excluded service competition, boosted service prices, and forced unwilling consumption.")

[16] Under the Court of Appeals' analysis, the franchisee cooperative which was foreclosed from entering the Domino's aftermarket for Ingredients and Supplies has no remedy at all, even though the cooperative is in the same market position as were the ISOs in *Kodak*. *Compare Valley Products Co., Inc. v. Landmark*, 128 F.3d 398 (6th Cir. 1997), *with Heatransfer Corp. v. Volkswagenwerk A.G.*, 553 F.2d 964 (5th Cir. 1997). Furthermore, the inequality of bargaining power between franchisor and franchisee usually leaves the franchisee without an adequate contractual remedy. *See generally* Hadfield, *Problematic*

This sweeping pronouncement immunizes a huge sector of the American economy from antitrust scrutiny. As the panel majority acknowledged, "one third of all dollars spent in retailing transactions in the United States are paid to franchise outlets."[17] Indeed, the market in this case involves a franchisor "with revenues in excess of $1.8 million per year"[18] and franchisees which purchase $500 million in Ingredients and Supplies each year.

The majority opinion leaves this huge sector of the economy "virtually immune from antitrust scrutiny." 129 F.3d at ___, Pet. App. 48. As Judge Becker wrote, even if such blanket immunity were appropriate for a "nascent" industry, it is completely inappropriate for the very mature fast food franchising industry:

> But now the food franchisors are leviathans, and I am underwhelmed by the suggestion that they may be permitted with impunity to perpetrate the type of arrangements pled in the complaint. These arrangements are clearly quite onerous to the average franchisee, a relatively small businessperson whose sunk costs in the franchise represent all or most of his or her assets and who lacks the considerable resources necessary to switch or defranchise.

129 F.3d at ___, Pet. App. 50.

Relations: Franchising and Law of Incomplete Contracts, 42 STAN L. REV. 927 (1990).

[17] 124 F.3d at 441, Pet. App. 23 (*citing* Grimes, *When Do Franchisors Have Market Power? Antitrust Remedies for Franchisor Opportunism*, 65 ANTITRUST L.J. 105, 105 n.1 (1996)).

[18] 124 F.3d at 433, Pet. App. 3.

In conferring this grant of immunity, the Court of Appeals relied upon economic theories predicting how markets should behave, rather than assuming as true the complaint's factual allegations how those markets have actually behaved. The Court of Appeals' holding that all franchisee derivative aftermarket cases should be dismissed at the pleading stage, without any discovery, violates a central holding of *Kodak:*

> Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law. This Court has preferred to resolve antitrust claims on a case-by-case basis, focusing on the "particular facts disclosed by the record. . . . "

Kodak, 504 U.S. at 466.

Because of the great importance of this issue to the proper application of the antitrust laws to so large a sector of the economy, the writ should be granted.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Filed August 27, 1997

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 96-1638

QUEEN CITY PIZZA, INC.; THOMAS C. BOLGER; SCALE PIZZA, INC.; BAUGHANS, INC.; CHARLES F. BUCK; F.M. PIZZA, INC.; ROBERT S. BIGELOW; BLUE EARTH ENTERPRISES, INC.; KEVIN BORES; DAVIS PIZZA ENTERPRISES, INC.; DIANE A. DAVIS; FISHER PIZZA, INC.; JAMES B. FISHER, JR.; SEPCO, INC.; S&S PIZZA CORP.; G&L PIZZA CO.; STEPHEN D. GALLUP; LUGENT PIZZA, INC.; JOSEPH J. LUGENT; BILLIO'S PIZZA, INC.; WILLIAM J. MURTHA; SPRING GARDEN PIZZA, INC; BRAD L. WALKER; JRW PIZZA, INC.; JAMES R. WOOD, Individually and as Class Representatives of a Class Consisting of All Present and Certain Former Domino's Franchisees in the United States; International Franchise Advisory Council, Inc.,

v.

DOMINO'S PIZZA, INC.; Queen City Pizza, Inc.; Thomas C. Bolger; Scale Pizza, Inc.; Baughans, Inc.; Charles F. Buck; F.M. Pizza, Inc.; Robert S. Bigelow; Blue Earth Enterprises, Inc.; Kevin Bores; Davis Pizza Enterprises, Inc.; Diane A. Davis; Fisher Pizza, Inc.; James B. Fisher, Jr.; SEPCO, Inc.; S&S Pizza, Inc.; G&L Pizza, Inc.; Stephen D. Gallup; Lugent Pizza, Inc.; Joseph J. Lugent; Billio's Pizza, Inc.; William J. Murtha; Spring Garden Pizza, Inc.; Brad L. Walker; JRW Pizza, Inc.; James R. Wood; and International Franchise Advisory Council, Inc.,

Appellants

On Appeal from the United States District Court for the Eastern District of Pennsylvania
(D.C. Civil Action No. 95-cv-03777)

Argued February 28, 1997

Before: SCIRICA, ALITO and LAY,* *Circuit Judges;*

(Filed August 27, 1997)

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OPINION OF THE COURT

SCIRICA, *Circuit Judge.*

In this appeal, we must decide whether certain franchise tying restrictions support a claim for violation of federal antitrust laws. Eleven franchisees of Domino's Pizza stores and the International Franchise Advisory

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* The Honorable Donald P. Lay, United States Circuit Judge for the Eighth Judicial Circuit, sitting by designation.

Council, Inc. filed suit against Domino's Pizza, Inc., alleging violations of federal antitrust laws, breach of contract, and tortious interference with contract. The district court dismissed the antitrust claims under Fed. R. Civ. P. 12(b)(6) for failure to state a claim for which relief can be granted, because the plaintiffs failed to allege a valid relevant market. The district court declined to exercise supplemental jurisdiction over the plaintiffs' remaining common law claims. *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 922 F. Supp. 1055 (E.D. Pa. 1996). We will affirm.

I. Facts and Procedural History

A.

Domino's Pizza, Inc. is a fast-food service company that sells pizza through a national network of over 4200 stores. Domino's Pizza owns and operates approximately 700 of these stores. Independent franchisees own and operate the remaining 3500. Domino's Pizza, Inc. is the second largest pizza company in the United States, with revenues in excess of $1.8 billion per year.

A franchisee joins the Domino's system by executing a standard franchise agreement with Domino's Pizza, Inc. Under the franchise agreement, the franchisee receives the right to sell pizza under the "Domino's" name and format. In return, Domino's Pizza receives franchise fees and royalties.

The essence of a successful nationwide fast-food chain is product uniformity and consistency. Uniformity benefits franchisees because customers can purchase

pizza from any Domino's store and be certain the pizza will taste exactly like the Domino's pizza with which they are familiar. This means that individual franchisees need not build up their own good will. Uniformity also benefits the franchisor. It ensures the brand name will continue to attract and hold customers, increasing franchise fees and royalties.[1]

For these reasons, section 12.2 of the Domino's Pizza standard franchise agreement requires that all pizza ingredients, beverages, and packaging materials used by a Domino's franchisee conform to the standards set by Domino's Pizza, Inc. Section 12.2 also provides that Domino's Pizza, Inc. "may in our sole discretion require that ingredients, supplies and materials used in the preparation, packaging, and delivery of pizza be purchased exclusively from us or from approved suppliers or distributors." Domino's Pizza reserves the right "to impose reasonable limitations on the number of approved suppliers or distributors of any product." To enforce these rights, Domino's Pizza, Inc. retains the power to inspect franchisee stores and to test materials and ingredients. Section 12.2 is subject to a reasonableness clause providing that Domino's Pizza, Inc. must "exercise reasonable judgment with respect to all determinations to be made by us under the terms of this Agreement."

Under the standard franchise agreement, Domino's Pizza, Inc. sells approximately 90% of the $500 million in

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[1] *See* the analysis of the economics of franchising in Warren S. Grimes, *When Do Franchisors Have Market Power?*, 65 Antitrust L.J. 105, 107-110 (1996).

ingredients and supplies used by Domino's franchisees.[2] These sales, worth some $450 million per year, form a significant part of Domino's Pizza, Inc.'s profits. Franchisees purchase only 10% of their ingredients and supplies from outside sources. With the exception of fresh dough, Domino's Pizza, Inc. does not manufacture the products it sells to franchisees. Instead, it purchases these products from approved suppliers and then resells them to the franchisees at a markup.

B.

The plaintiffs in this case are eleven Domino's franchisees and the International Franchise Advisory Council, Inc. ("IFAC"), a Michigan corporation consisting of approximately 40% of the Domino's franchisees in the United States, formed to promote their common interests.[3] The plaintiffs contend that Domino's Pizza, Inc. has a monopoly in "the $500 million aftermarket for sales of supplies to Domino's franchisees" and has used its monopoly power to unreasonably restrain trade, limit

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[2] Domino's Pizza, Inc. sells ingredients and supplies through its division, Domino's Pizza Distribution Division, "DPDD." DPDD was formerly a subsidiary of Domino's Pizza, Inc.

[3] Domino's Pizza, Inc. argued before the district court that IFAC is without standing in this case. *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 922 F. Supp. 1055, 1057 (E.D. Pa. 1996). The district court apparently found it unnecessary to address this issue in light of its order dismissing the case for failure to state a claim.

competition, and extract supra-competitive profits. Plaintiffs point to several actions by Domino's Pizza, Inc. to support their claims.

First, plaintiffs allege that Domino's Pizza, Inc. has restricted their ability to purchase competitively priced dough. Most franchisees purchase all of their fresh dough from Domino's Pizza, Inc. Plaintiffs here attempted to lower costs by making fresh pizza dough on site. They contend that in response, Domino's Pizza, Inc. increased processing fees and altered quality standards and inspection practices for store-produced dough, which eliminated all potential savings and financial incentives to make their own dough. Plaintiffs also allege Domino's Pizza, Inc. prohibited stores that produce dough from selling their dough to other franchisees, even though the dough-producing stores were willing to sell dough at a price 25% to 40% below Domino's Pizza, Inc.'s price.

Next, plaintiffs object to efforts by Domino's Pizza, Inc. to block IFAC's attempt to buy less expensive ingredients and supplies from other sources. In June 1994, IFAC entered into a purchasing agreement with FoodService Purchasing Cooperative, Inc. (FPC). Under the agreement, FPC was appointed the purchasing agent for IFAC-member Domino's franchisees. FPC was charged with developing a cooperative purchasing plan under which participating franchisees could obtain supplies and ingredients at reduced cost from suppliers other than Domino's Pizza, Inc. Plaintiffs contend that when Domino's Pizza, Inc. became aware of these efforts, it intentionally issued ingredient and supply specifications so vague that potential suppliers could not provide FPC with meaningful price quotations.

Plaintiffs also allege Domino's Pizza entered into exclusive dealing arrangements with several franchisees in order to deny FPC access to a pool of potential buyers sufficiently large to make the alternative purchasing scheme economically feasible. In addition, plaintiffs contend Domino's Pizza, Inc. commenced anti-competitive predatory pricing to shut FPC out of the market. For example, they maintain that Domino's Pizza, Inc. lowered prices on many ingredients and supplies to a level competitive with FPC's prices and then recouped lost profits by raising the price on fresh dough, which FPC could not supply. Further, plaintiffs contend Domino's Pizza, Inc. entered into exclusive dealing arrangements with the only approved suppliers of ready-made deep dish crusts and sauce. Under these agreements, the suppliers were obligated to deliver their entire output to Domino's Pizza, Inc. Plaintiffs allege the purpose of these agreements was to prevent FPC from purchasing these critical pizza components for resale to franchisees.

Finally, plaintiffs allege Domino's Pizza, Inc. refused to sell fresh dough to franchisees unless the franchisees purchased other ingredients and supplies from Domino's Pizza, Inc. As a result of these and other alleged practices, plaintiffs maintain that each franchisee store now pays between $3000 and $10,000 more per year for ingredients and supplies than it would in a competitive market. Plaintiffs allege these costs are passed on to consumers.

C.

As noted, eleven Domino's franchisees and IFAC filed an amended complaint in United States District

Court for the Eastern District of Pennsylvania against Domino's Pizza, Inc. seeking declaratory, injunctive, and compensatory relief under §§ 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 and 2. The plaintiffs also sought damages for breach of contract, breach of implied covenants of good faith and fair dealing, and tortious interference with contractual relations.[4]

Domino's Pizza, Inc. moved to dismiss the antitrust claims for failure to state a claim, contending the plaintiffs failed to allege a "relevant market," a basic pleading requirement for claims under both § 1 and § 2 of the Sherman antitrust act. They maintained that the relevant market defined in the complaint – the "market" in Domino's-approved ingredients and supplies used by Domino's Pizza franchisees – was invalid as a matter of law because the boundaries of the proposed relevant market were defined by contractual terms contained in the franchise agreement, and not measured by cross-elasticity of demand or product interchangeability.

The district court granted defendant's motion to dismiss with prejudice plaintiffs' federal antitrust claims. The district court observed that "in order to state a Sherman Act claim under either § 1 or § 2, a plaintiff must identify the relevant product and geographic markets and allege that the defendant exercises market power within those markets." *Queen City Pizza, Inc. v. Domino's Pizza,*

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[4] The plaintiffs originally filed the complaint on behalf of themselves and a purported class of all present and future Domino's franchisees in the United States. Their amended complaint abandoned their claim to represent all Domino's franchisees.

Inc., 922 F. Supp. 1055, 1060 (E.D. Pa. 1996). Noting that plaintiffs did "not explicitly identify the relevant product and geographic markets in their amended complaint," the court said that "it is clear from the context, and confirmed in their memorandum in opposition to the instant motion, that Plaintiffs consider the relevant product market to be the market for ingredients and supplies among Domino's franchisees." *Id.* at 1061. Rejecting this concept of the relevant market, the court held that "antitrust claims predicated upon a 'relevant market' defined by the bounds of a franchise agreement are not cognizable." *Id.* at 1063. The court noted that Domino's Pizza, Inc.'s power to force plaintiffs to purchase ingredients and supplies from them stemmed "not from the unique nature of the product or from its market share in the fast food franchise business, but from the franchise agreement." *Id.* at 1062. For that reason, plaintiffs' claims "implicate principles of contract, and are not the concern of the antitrust laws." *Id.* The district court also held plaintiffs had failed adequately to allege harm to competition, "a bedrock premise of antitrust law." *Id.* at 1063. Because plaintiffs failed to assert a cognizable antitrust claim and there was neither diversity among the parties nor special circumstances justifying exercise of supplemental jurisdiction, the court dismissed without prejudice plaintiffs' common law claims for lack of subject matter jurisdiction. *Id.* at 1063-64.

The district court granted plaintiffs leave to file an amended complaint to cure the jurisdictional pleading deficiencies in their state law claims. Plaintiffs decided not to replead their state law claims. Instead, they sought to amend their complaint for a second time in an attempt

to state a valid federal antitrust claim. The district court denied their motion, noting that though the plaintiffs' proposed second amended complaint would cure the failure to plead harm to competition, it would not cure the failure to allege a valid relevant market. The court stated: "Plaintiffs do not and cannot purchase ingredients and supplies from alternative suppliers not because Domino's dominates the ingredient and supply market or because Defendant is the market's only supplier, but because the franchisee-plaintiffs are contractually bound to purchase only from suppliers approved by Defendant. It is economic power resulting from the franchise agreement, therefore, and not market power, that defines the 'relevant market' Plaintiffs allege in support of their antitrust claims." The district court rejected plaintiffs' argument that a different result was required under the Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451 (1992). This appeal followed.

II. Jurisdiction and Standard of Review

The district court had jurisdiction over the antitrust counts under 15 U.S.C. §§ 15 and 26 and 28 U.S.C. §§ 1331 and 1337. It declined to exercise supplemental jurisdiction over the common law counts. We have jurisdiction under 28 U.S.C. § 1291. Our review of the district court's dismissal under Fed. R. Civ. P. 12(b)(1) and 12(b)(6) is plenary. *Stehney v. Perry*, 101 F.3d 925 (3d Cir. 1996).

III. Discussion

Plaintiffs assert six distinct antitrust claims on appeal. First, plaintiffs allege Domino's Pizza, Inc. has

monopolized the market in pizza supplies and ingredients for use in Domino's stores, in violation of § 2 of the Sherman Act, 15 U.S.C. § 2. In support of this contention, plaintiffs allege Domino's Pizza, Inc. has sufficient market power to control prices and exclude competition in this market. Second, plaintiffs contend Domino's Pizza, Inc. has attempted to monopolize the market for Domino's pizza supplies and ingredients, in violation of § 2 of the Sherman Act. Third, plaintiffs allege Domino's Pizza, Inc.'s exclusive dealing arrangements have unreasonably restrained trade in violation of § 1 of the Sherman Act, 15 U.S.C. § 1. Fourth, plaintiffs allege Domino's Pizza, Inc. imposed an unlawful tying arrangement[5] by requiring franchisees to buy ingredients and supplies from them as a condition of obtaining fresh dough, in violation of the Sherman Act § 1, 15 U.S.C. § 1. Fifth, plaintiffs allege Domino's Pizza, Inc. imposed an unlawful tying arrangement by requiring franchisees to buy ingredients and supplies "as a condition of their continued enjoyment of rights and services under their Standard Franchise Agreement," in violation of § 1 of the Sherman Act, 15 U.S.C. § 1. Sixth, plaintiffs allege Domino's Pizza, Inc. has monopoly power in a relevant "market for reasonably interchangeable franchise opportunities facing prospective franchisees," in violation of § 2 of the Sherman Act, 15 U.S.C. § 2. This last claim was not raised before the district court.

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[5] "In a tying arrangement, the seller sells one item, known as the tying product, on the condition that the buyer also purchases another item, known as the tied product." *Allen-Myland, Inc. v. International Business Machines Corp.*, 33 F.3d 194, 200 (3d Cir. 1994).

As we have noted, the district court held that none of the plaintiffs' antitrust claims was cognizable under federal law. We will analyze each claim in turn.

A.

As a threshold matter, plaintiffs argue that "relevant market determinations are inherently fact intensive, and therefore are inappropriate for disposition on a Rule 12(b)(6) motion." (Appellant's brief at 16). It is true that in most cases, proper market definition can be determined only after a factual inquiry into the commercial realities faced by consumers. *See Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 482 (1992). Plaintiffs err, however, when they try to turn this general rule into a *per se* prohibition against dismissal of antitrust claims for failure to plead a relevant market under Fed. R. Civ. P. 12(b)(6).

Plaintiffs have the burden of defining the relevant market. *Pastore v. Bell Telephone Co. of Pennsylvania*, 24 F.3d 508, 512 (3d Cir. 1994); *Tunis Bros. Co., Inc. v. Ford Motor Co.*, 952 F.2d 715, 726 (3d Cir. 1991). "The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 325 (1962); *Tunis Brothers*, 952 F.2d at 722 (same). Where the plaintiff fails to define its proposed relevant market with reference to the rule of reasonable interchangeability and cross-elasticity of demand, or alleges a proposed relevant market that clearly does not encompass all interchangeable substitute products even when all factual inferences are

granted in plaintiff's favor, the relevant market is legally insufficient and a motion to dismiss may be granted. *See, e.g., TV Communications Network, Inc. v. Turner Network Television, Inc.*, 964 F.2d 1022, 1025 (10th Cir. 1992) (affirming district court's dismissal of claim for failure to plead a relevant market; proposed relevant market consisting of only one specific television channel defined too narrowly); *Tower Air, Inc. v. Federal Exp. Corp.*, 956 F. Supp. 270 (E.D.N.Y. 1996) ("Because a relevant market includes all products that are reasonably interchangeable, plaintiff's failure to define its market by reference to the rule of reasonable interchangeability is, standing alone, valid grounds for dismissal."); *B.V. Optische Industrie De Oude Delft v. Hologic, Inc.*, 909 F. Supp. 162 (S.D.N.Y. 1995) (dismissal for failure to plead a valid relevant market; plaintiffs failed to define market in terms of reasonable interchangeability or explain rationale underlying narrow proposed market definition); *Re-Alco Industries, Inc. v. Nat'l Center for Health Educ., Inc.*, 812 F. Supp. 387 (S.D.N.Y. 1993) (dismissal for failure to plead a valid relevant market; plaintiff failed to allege that specific health education product was unique or explain why product was not part of the larger market for health education materials); *E. & G. Gabriel v. Gabriel Bros., Inc.*, No. 93 Civ. 0894, 1994 WL 369147 (S.D.N.Y. 1994) (dismissal for failure to plead valid relevant market; proposed relevant market legally insufficient because it clearly contained varied items with no cross-elasticity of demand).

B.

Plaintiffs allege Domino's Pizza, Inc. has willfully acquired and maintained a monopoly in the market for ingredients, supplies, materials and distribution services used in the operation of Domino's stores, in violation of § 2 of the Sherman Act, 15 U.S.C. § 2. Section 2 sanctions those "who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations." "The offense of monopoly under § 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 596 n. 19 (1985) (quoting *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966)). *See also Ideal Dairy Farms, Inc. v. John Labatt, Ltd.*, 90 F.3d 737, 749 (3d Cir. 1996) (same); *Bonjorno v. Kaiser Aluminum & Chemical Corp.*, 752 F.2d 802, 808 (3d Cir. 1984) (same).

The district court dismissed plaintiffs' § 2 monopoly claims for failure to plead a valid relevant market. Plaintiffs suggest the "ingredients, supplies, materials, and distribution services used by and in the operation of Domino's pizza stores" constitutes a relevant market for antitrust purposes. We disagree.

As we have noted, the outer boundaries of a relevant market are determined by reasonable interchangeability of use. *Eastman Kodak Co. v. Image Technical Services, Inc.*,

504 U.S. 451, 482 (1992); *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 325 (1962); *Tunis Brothers Co., Inc. v. Ford Motor Co.*, 952 F.2d 715, 722 (3d Cir. 1991). "Interchangeability implies that one product is roughly equivalent to another for the use to which it is put; while there may be some degree of preference for the one over the other, either would work effectively. A person needing transportation to work could accordingly buy a Ford or a Chevrolet automobile, or could elect to ride a horse or bicycle, assuming those options were feasible." *Allen-Myland, Inc. v. International Business Machines Corp.*, 33 F.3d 194, 206 (3d Cir. 1994) (internal quotations omitted). When assessing reasonable interchangeability, "[f]actors to be considered include price, use, and qualities." *Tunis Brothers*, 952 F.2d at 722. Reasonable interchangeability is also indicated by "cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 325 (1962). As we explained in *Tunis Brothers Co., Inc. v. Ford Motor Co.*, 952 F.2d 715, 722 (3d Cir. 1991), "products in a relevant market [are] characterized by a cross-elasticity of demand, in other words, the rise in the price of a good within a relevant product market would tend to create a greater demand for other like goods in that market." *Tunis Brothers*, 952 F.2d at 722.[6]

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[6] Cross-elasticity is a measure of reasonable interchangeability. As one treatise observes: "The economic tool most commonly referred to in determining what should be included in the market from which one then determines the defendant's market share is cross-elasticity of demand. Cross-elasticity of demand is a measure of the substitutability of products from the point of view of buyers. More technically, it measures the responsiveness of the demand for one product to changes in the price of a different product." E. Thomas Sullivan

Here, the dough, tomato sauce, and paper cups that meet Domino's Pizza, Inc. standards and are used by Domino's stores are interchangeable with dough, sauce and cups available from other suppliers and used by other pizza companies. Indeed, it is the availability of interchangeable ingredients of comparable quality from other suppliers, at lower cost, that motivates this lawsuit. Thus, the relevant market, which is defined to include all reasonably interchangeable products, cannot be restricted solely to those products currently approved by Domino's Pizza, Inc. for use by Domino's franchisees. For that reason, we must reject plaintiffs' proposed relevant market.

Of course, Domino's-approved pizza ingredients and supplies differ from other available ingredients and supplies in one crucial manner. Only Domino's-approved products may be used by Domino's franchisees without violating section 12.2 of Domino's standard franchise agreement. Plaintiffs suggest that this difference is sufficient by itself to create a relevant market in approved products. We disagree. The test for a relevant market is not commodities reasonably interchangeable by a particular plaintiff, but "commodities reasonably interchangeable by consumers for the same purposes." *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956); *Tunis Brothers*, 952 F.2d at 722. A court making a relevant market determination looks not to the contractual restraints assumed by a particular plaintiff when determining whether a product is interchangeable, but to the

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and Jeffrey L. Harrison, *Understanding Antitrust and its Economic Implications* 217 (1994).

uses to which the product is put by consumers in general. Thus, the relevant inquiry here is not whether a Domino's franchisee may reasonably use both approved or non-approved products interchangeably without triggering liability for breach of contract, but whether pizza makers in general might use such products interchangeably. Clearly, they could. Were we to adopt plaintiffs' position that contractual restraints render otherwise identical products non-interchangeable for purposes of relevant market definition, any exclusive dealing arrangement, output or requirement contract, or franchise tying agreement would support a claim for violation of antitrust laws. Perhaps for this reason, no court has defined a relevant product market with reference to the particular contractual restraints of the plaintiff.[7] Indeed, the only cases we have found involving similar claims rejected plaintiffs' position as a matter of law. *See United Farmers Agents Ass'n, Inc. v. Farmers Ins. Exchange*, 89 F.3d 233 (5th Cir. 1996) ("Economic power derived from contractual arrangements such as franchises or in this case, the agents' contract with Farmers', has nothing to do with market power, ultimate consumers' welfare, or antitrust.") (internal citation and quotation omitted), *cert. denied*, ___ U.S. ___, 117 S. Ct. 960 (1997); *Ajir v. Exxon*

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[7] In *Mozart Co. v. Mercedes-Benz of North America*, 833 F.2d 1342 (9th Cir. 1987), the Court of Appeals for the Ninth Circuit observed that market power exists in three circumstances: where the government has granted a seller a patent or similar monopoly, where the seller possesses a unique product, or where the seller possesses a high market share. *Id.* at 1345-1346. The court made no mention of contractual limitations as a source of market power.

Corp., No. C 93-20830, 1995 WL 429234, *3 (N.D. Ca.) ("Just because Exxon's direct serve dealers may contractually purchase gasoline from only one source – Exxon – does not mean that the relevant market is Exxon gasoline"; the correct relevant market is all gasoline). *See also Seagood Trading Corp. v. Jerrico, Inc.*, 924 F.2d 1555, 1570 n. 39 (11th Cir. 1991) (declining to reach issue but noting the district court rejected plaintiffs' claim that proposed market for sales of supplies to Long John Silver's fast food stores was a relevant market for antitrust purposes).

Plaintiffs argue that the Supreme Court's decision defining relevant markets in *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451 (1992) requires a different outcome. We disagree.

In *Kodak*, the Supreme Court observed that a market is defined with reference to reasonable interchangeability. *Kodak*, 504 U.S. at 482. The Court held that the market for repair parts and services for Kodak photo-copiers was a valid relevant market because repair parts and services for Kodak machines are not interchangeable with the service and parts used to fix other copiers. *Id.* Plaintiffs suggest that *Kodak* supports its proposed relevant market because it indicates that in some circumstances, a single brand of a product or service may constitute a relevant market. This is correct where the commodity is unique, and therefore not interchangeable with other products. But here, it is uncontested that contractual restraints aside, the sauce, dough, and other products and ingredients approved for use by Domino's franchisees are interchangeable with other items available on the market.

Plaintiffs contend that they face information and switching costs that "lock them in" to their position as Domino's franchisees, making it economically impracticable for them to abandon the Domino's system and enter a different line of business. They argue that under *Kodak*, the fact that they are "locked in" supports their claim that an "aftermarket" for Domino's-approved supplies is a relevant market for antitrust purposes. We believe plaintiffs misread *Kodak*.

The defendants in *Kodak* argued that there was no relevant market in Kodak repair parts, even if they were unique and non-interchangeable with other repair parts, because of cross-elasticity of demand between parts prices and copier sales. If the price of parts were raised too high, defendants contended, it would decrease demand for copiers.[8] The Court held that whether there was cross-elasticity of demand between parts and copiers was, in this case, a factual question that could not be determined as a matter of law. The Court reached this conclusion because switching and information costs arise when one purchases an expensive piece of equipment like a copier. In some circumstances, these costs might create

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[8] In a typical antitrust case, plaintiffs assert that the products or services in their proposed relevant market are reasonably interchangeable because they possess positive cross-elasticity of demand: a rise in the price of one product in the market will increase demand for the other items in the market. By contrast, in *Kodak* the defendants argued that Kodak copier parts, though not reasonably interchangeable with the copiers themselves, were not a relevant market because of negative cross-elasticity between parts and copiers: an increase in the price of parts would, they argued, decrease demand for copiers using those parts.

an economic lock-in that could reduce or eliminate the cross-elasticity of demand between copiers and the repair parts for those copiers.

Kodak, we believe, held that a plaintiff's proposed relevant market in a unique and non-interchangeable derivative product or service cannot be defeated on summary judgment by a defendant's assertion that the proposed derivative market is cross-elastic with the primary market, if there is a reasonable possibility that the defendant's assertion about cross-elasticity is factually incorrect. But *Kodak* does not hold that the existence of information and switching costs alone, such as those faced by the Domino's franchisees,[9] renders an otherwise invalid relevant market valid.[10] In *Kodak,* the repair parts and service were unique and there was a question of fact about cross-elasticity. Judgment as a matter of law was therefore inappropriate. Here, it is uncontroverted that

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[9] A franchisee considering exiting one franchise system faces information costs associated with researching alternative investment opportunities and switching costs stemming from the loss of invested funds that may not be recovered if it abandons its current business and start-up costs associated with the new venture.

[10] If Kodak repair parts had not been unique, but rather, could be obtained from additional sources at a reasonable price, Kodak could not have forced copier purchasers to buy repair parts from Kodak. This would be true even if the copier purchasers faced information and switching costs that locked them into to use of Kodak copiers. This fact indicates that switching and information costs alone cannot create market power. Rather, it is the lack of a competitive market in the object to be purchased – for instance, a competitive market in Kodak parts – that gives a company market power.

Domino's approved supplies and ingredients are fully interchangeable in all relevant respects with other pizza supplies outside the proposed relevant market. For this reason, dismissal of the plaintiffs' claim as a matter of law is appropriate.

Kodak is distinguishable from the present appeal in other important respects. The *Kodak* case arose out of concerns about unilateral changes in Kodak's parts and repairs policies. When the copiers were first sold, Kodak relied on purchasers to obtain service from independent service providers. Later, it chose to use its power over the market in unique replacement parts to squeeze the independent service providers out of the repair market and to force copier purchasers to obtain service directly from Kodak, at higher cost. Because this change in policy was not foreseen at the time of sale, buyers had no ability to calculate these higher costs at the time of purchase and incorporate them into their purchase decision. In contrast, plaintiffs here knew that Domino's Pizza retained significant power over their ability to purchase cheaper supplies from alternative sources because that authority was spelled out in detail in section 12.2 of the standard franchise agreement. Unlike the plaintiffs in *Kodak,* the Domino's franchisees could assess the potential costs and economic risks at the time they signed the franchise agreement. The franchise transaction between Domino's Pizza, Inc. and plaintiffs was subjected to competition at the pre-contract stage. That cannot be said of the conduct challenged in *Kodak* because it was not authorized by contract terms disclosed at the time of the original transaction. Kodak's sale of its product involved no contractual framework for continuing relations with the

purchaser. But a franchise agreement regulating supplies, inspections, and quality standards structures an ongoing relationship between franchisor and franchisee designed to maintain good will. These differences between the *Kodak* transaction and franchise transactions are compelling.[11]

Plaintiffs also contend that *Virtual Maintenance, Inc. v. Prime Computer, Inc.*, 11 F.3d 660 (6th Cir. 1993), supports their claim that the boundaries of a relevant market may be defined by contract. In *Virtual Maintenance*, Ford Motor Co. granted Prime Computer an exclusive right to market Ford-designed software and software revisions that automobile design companies must use to design cars for Ford. Prime Computer sold the software revisions only in a package with uncompetitive hardware maintenance services. The Court of Appeals for the Sixth Circuit held that Prime could not legally exercise its monopoly power over software revisions to force customers to buy unwanted hardware maintenance contracts. Plaintiffs note that Prime's *de facto* monopoly power over software stemmed from a contract with Ford, which they argue implies that the boundaries of a market may be defined by contract. But Prime had a monopoly because it possessed a unique product that no one else sold. Since the product was unique, and not interchangeable with any other products, it constituted its own relevant market for antitrust purposes. By contrast, Domino's does not sell a unique product or service. Franchisees must buy Domino's-approved supplies and ingredients

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[11] *See* Alan Silberman, *The Myths of Franchise "Market Power"*, 65 Antitrust L.J. 181, 217 (1996).

not because they are unique, but because they are obligated by contract to do so.

Were we to accept plaintiffs' relevant market, virtually all franchise tying agreements requiring the franchisee to purchase inputs such as ingredients and supplies from the franchisor would violate antitrust law. Courts and legal commentators have long recognized that franchise tying contracts are an essential and important aspect of the franchise form of business organization because they reduce agency costs and prevent franchisees from freeriding – offering products of sub-standard quality insufficient to maintain the reputational value of the franchise product while benefitting from the quality control efforts of other actors in the franchise system.[12] Franchising is a bedrock of the American economy. More than one third of all dollars spent in retailing transactions in the United States are paid to franchise outlets.[13] We do not believe the antitrust laws were designed to erect a serious barrier to this form of business organization.[14]

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[12] *See Mozart Co. v. Mercedes-Benz of North America, Inc.*, 833 F.2d 1342, 1349-50 (9th Cir. 1987); Alan J. Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 Mich. L.Rev. 111, 117-119 (1996); Warren S. Grimes, *When Do Franchisors Have Market Power?*, 65 Antitrust L.J. 105 145-47 (1996); Benjamin Klein and Lester F. Saft, *The Law and Economics of Franchise Tying Contracts*, 28 J.L. & Econ. 345, 346-48 (1985).

[13] Warren S. Grimes, *When Do Franchisors Have Market Power?*, 65 Antitrust L.J. 105, 105 n.1 (1996).

[14] *See United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 387 (1967) (Stewart, J., concurring in part and dissenting in part) ("Indiscriminate invalidation of franchising arrangements would eliminate their creative contributions to competition and

The purpose of the Sherman Act "is not to protect businesses from the working of the market; it is to protect the public from the failure of the market." *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993). Here, plaintiffs' acceptance of a franchise package that included purchase requirements and contractual restrictions is consistent with the existence of a competitive market in which franchises are valued, in part, according to the terms of the proposed franchise agreement and the availability of alternative franchise opportunities. Plaintiffs need not have become Domino's franchisees. If the contractual restrictions in section 12.2 of the general franchise agreement were viewed as overly burdensome or risky at the time they were proposed, plaintiffs could have purchased a different form of restaurant, or made some alternative investment.[15] They chose not to do so. Unlike the plaintiffs in *Kodak*, plaintiffs here must purchase products from Domino's Pizza not because of Domino's market power over a unique product, but because they are bound by contract to do so. If Domino's Pizza, Inc. acted unreasonably when, under the franchise agreement, it restricted plaintiffs' ability to purchase supplies

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force suppliers to abandon franchising and integrate forward to the detriment of small business. In other words, we may inadvertently compel concentration by misguided zealousness.") (internal quotations omitted). The majority's opinion in *Arnold* was later overturned. *See Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

[15] As one scholar has noted, there are thousands of franchise opportunities available to investors and disclosure laws to help them make informed choices about these alternatives. George A. Hay, *Is the Glass Half-Empty or Half-Full?: Reflections on the Kodak Case*, 62 Antitrust L.J. 177, 188 (1993).

from other sources, plaintiffs' remedy, if any, is in contract, not under the antitrust laws.[16]

For these reasons, we agree with the district court that plaintiffs have not pleaded a valid relevant market.[17]

C.

Plaintiffs' claim for attempt to monopolize fails for the same reasons. To prevail on an attempted monopolization claim under § 2 of the Sherman Act, "a plaintiff

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[16] The dissent contends Domino's has acted in a "predatory way." But plaintiffs may have a right to sue for breach of contract.

[17] The reasoning adopted by the district court in this case has been criticized recently by two other district court decisions. *See Wilson v. Mobil Oil Corp.*, 940 F. Supp. 944 (E.D. La. 1996); *Collins v. International Dairy Queen, Inc.*, 939 F. Supp. 875 (M.D. Ga. 1996). In *Wilson*, the court disagreed with the district court's interpretation of *Kodak*, arguing that under *Kodak* information and switching costs alone, absent a unique product or service, may create a relevant market for antitrust purposes. As noted above, we disagree with this interpretation, for the Supreme Court specifically found that the copier parts involved in the case were unique. The basis of the *Collins* court's criticism of the district court's decision here is less clear, though it appears the court believed that the district court's holding was too expansive. The *Collins* court apparently wished to reserve judgment whether some franchise tying arrangements might be deemed anti-competitive in the future. The approach taken by the district court in this case has received support in recent scholarly literature. *See* Alan J. Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 Mich. L. Rev. 111, 128 (1996) ("economic theory suggests . . . that tying contracts that actually reduce free riding are unrelated to any exercise of market power"); Alan H. Silberman, *The Myths of Franchise "Market Power"*, 65 Antitrust L.J. 181 (1996).

must prove that the defendant (1) engaged in predatory or anticompetitive conduct with (2) specific intent to monopolize and with (3) a dangerous probability of achieving monopoly power." *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993). *Ideal Dairy Farms, Inc. v. John Labatt, Ltd.*, 90 F.3d 737, 750 (3d Cir. 1996); *Advo, Inc. v. Philadelphia Newspapers, Inc.*, 51 F.3d 1191, 1197 (3d Cir. 1995). In order to determine whether there is a dangerous probability of monopolization, a court must inquire "into the relevant product and geographic market and the defendant's economic power in that market." *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 459 (1993); *Ideal Dairy Farms* at 750; *Pastore v. Bell Telephone Co. of Pennsylvania*, 24 F.3d 508, 512 (3d Cir. 1994).

Plaintiffs' attempted monopoly claim is predicated on the identical proposed relevant market underlying its monopoly claim: a market in the ingredients, supplies, and materials used by Domino's pizza stores. Because the products within this proposed market are interchangeable with other products outside of the proposed market, the claim was properly dismissed.

D.

Plaintiffs allege exclusive dealing arrangements entered into by Domino's Pizza, Inc. have unreasonably restrained trade in violation of § 1 of the Sherman Act, 15 U.S.C. § 1. Section 1 of the Sherman Act provides: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal." 15 U.S.C. § 1.

To establish a section 1 violation for unreasonable restraint of trade, a plaintiff must prove (1) concerted action by the defendants; (2) that produced anti-competitive effects within the relevant product and geographic markets; (3) that the concerted action was illegal; and (4) that the plaintiff was injured as a proximate result of the concerted action. *Mathews v. Lancaster General Hospital*, 87 F.3d 624, 639 (3d Cir. 1996); *Orson Inc. v. Miramax Film Corp.*, 79 F.3d 1358, 1366 (3d Cir. 1996); *Petruzzi's IGA Supermarkets, Inc. v. Darling-Delaware Co., Inc.*, 998 F.2d 1224, 1229 (3d Cir. 1993).

Plaintiffs allege defendant's actions caused anticompetitive effects within the market for ingredients and supplies used by Domino's pizza stores. Again, this claim fails because the products within the proposed market are interchangeable with products outside the proposed market.[18]

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[18] Monopoly power under § 2 requires "something greater" than market power under § 1. *Kodak*, 504 U.S. at 481. This does not imply, however, that the analyses employed in the two types of cases to define relevant markets differ. In the past, we intimated that the relevant market analysis required under § 2 of the Sherman Act was "instructive" in § 1 cases, though perhaps not identical. *See Tunis Bros.*, 952 F.2d at 724 n. 3. The Supreme Court and lower courts have consistently held that relevant markets under both sections are defined by the same two factors: reasonable interchangeability of use and cross-elasticities of demand. *See, e.g., Allen-Myland*, 33 F.3d at 201 and 201 n. 8 (applying *Brown Shoe* relevant market test of reasonable interchangeability and cross-elasticity of demand in § 1 tying case). In this case, we see no difference in the relevant market analyses required under the two provisions.

E.

Plaintiffs allege Domino's Pizza, Inc. imposed an unlawful tying arrangement by requiring franchisees to buy ingredients and supplies from them as a condition of obtaining Domino's Pizza fresh dough, in violation of § 1 of the Sherman Act, 15 U.S.C. § 1. "In a tying arrangement, the seller sells one item, known as the tying product, on the condition that the buyer also purchases another item, known as the tied product." *Allen-Myland, Inc. v. International Business Machines Corp.*, 33 F.3d 194, 200 (3d Cir. 1994). "[T]he antitrust concern over tying arrangements is limited to those situations in which the seller can exploit its power in the market for the tying product to force buyers to purchase the tied product when they otherwise would not, thereby restraining competition in the tied product market." *Id.* "Even if a seller has obtained a monopoly in the tying product legitimately (as by obtaining a patent), courts have seen the expansion of that power to other product markets as illegitimate and competition suppressing." *Town Sound and Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 475 (3d Cir. 1992). "The first inquiry in any § 1 tying case is whether the defendant has sufficient market power over the tying product, which requires a finding that two separate product markets exist and a determination precisely what the tying and tied products markets are." *Allen-Myland*, 33 F.3d at 200-201.

Here, plaintiffs allege Domino's Pizza, Inc. used its power in the purported market for Domino's-approved dough to force plaintiffs to buy unwanted ingredients and supplies from them. This claim fails because the proposed tying market – the market in Domino's-

approved dough – is not a relevant market for antitrust purposes. Domino's dough is reasonably interchangeable with other brands of pizza dough, and does not therefore constitute a relevant market of its own. All that distinguishes this dough from other brands is that a Domino's franchisee must use it or face a suit for breach of contract. As we have noted above, the particular contractual restraints assumed by a plaintiff are not sufficient by themselves to render interchangeable commodities non-interchangeable for purposes of relevant market definition. If Domino's had market power in the overall market for pizza dough and forced plaintiffs to purchase other unwanted ingredients to obtain dough, plaintiffs might possess a valid tying claim. But where the defendant's "power" to "force" plaintiffs to purchase the alleged tying product stems not from the market, but from plaintiffs' contractual agreement to purchase the tying product, no claim will lie. For that reason, plaintiffs' claim was properly dismissed.

F.

Plaintiffs allege Domino's Pizza, Inc. imposed an unlawful tie-in arrangement by requiring franchisees to buy ingredients and supplies "as a condition of their continued enjoyment of rights and services under their Standard Franchise Agreement," in violation of § 1 of the Sherman Act, 15 U.S.C. § 1. This claim is meritless. Though plaintiffs complain of an illegal tie-in arrangement, they have failed to point to any particular tying product or service over which Domino's Pizza, Inc, has market power. Domino's Pizza's control over plaintiffs' "continued enjoyment of rights and services under their

Standard Franchise Agreement" is not a "market." Rather, it is a function of Domino's contractual powers under the franchise agreement to terminate the participation of franchisees in the franchise system if they violate the agreement. Because plaintiffs failed to plead any relevant tying market, the claim was properly dismissed.

G.

On appeal, the plaintiffs advance a new claim based on a different relevant market theory – that Domino's has a monopoly in a relevant market comprised of pizza franchise opportunities of the type that Domino's Pizza, Inc. offers. Plaintiffs raise this new theory, which the district court did not address, in the hopes of obtaining a remand.

Plaintiffs' argument that Domino's Pizza has monopolized a relevant market comprised of franchise opportunities of a particular sort was not raised or mentioned in their complaint, first amended complaint, memorandum of law in support of their motion for leave to file a second amended complaint, or in the "claims for relief" section of the proposed second amended complaint. When the district court denied plaintiffs leave to file a second amended complaint, on grounds of futility, it had no idea that plaintiffs intended or desired to raise such a claim. "This court has consistently held that it will not consider issues that are raised for the first time on appeal." *Harris v. City of Philadelphia*, 35 F.3d 840, 845 (3d Cir. 1994).

Nonetheless, plaintiffs argue that this claim was raised before the district court. In support of this contention, they note that facts which might support such a claim were pleaded in paragraphs 60 and 65 of their proposed second amended complaint. Though we construe pleadings liberally, plaintiffs have a duty to make the district court aware that they intend to rely on a particular relevant market theory. This is particularly true in a complex case like this one, where plaintiffs bring multiple antitrust claims based on multiple and alternative relevant market theories. *See Pastore v. Bell Telephone Co. of Pennsylvania*, 24 F.3d 508, 513 (3d Cir. 1994) (plaintiff bound by relevant market theory raised before district court); *TV Communications Network, Inc. v. Turner Network Television, Inc.*, 964 F.2d 1022, 1025 (10th Cir. 1992) (same); *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.*, 637 F.2d 105, 117 (3d Cir. 1980) (same). We do not believe a fleeting reference in a proposed second amended complaint to facts that might support a proposed relevant market is sufficient, on its own, to preserve that relevant market theory for appellate review. *See Frank v. Colt Industries, Inc.*, 910 F.2d 90, 100 (3d Cir. 1990) (issues not raised before district court are waived on appeal; fleeting reference to issue before district court insufficient to preserve it for appellate review). "Particularly where important and complex issues of law are presented, a far more detailed exposition of argument is required to preserve an issue." *Id.* at 100. Because this claim was not properly raised before the district court and is not properly before us, we decline to address it. *See generally Salvation Army v. Department of Community Affairs of State of N.J.*, 919 F.2d 183, 196 (3d Cir. 1990) ("The matter of what questions

may be taken up and resolved for the first time on appeal is one left primarily to the discretion of the courts of appeals, to be exercised on the facts of each case.").

H.

Plaintiffs also contend the district court held that the availability of contract remedies prohibited recovery under antitrust laws. But this misstates the district court's holding. The district court held that Domino's Pizza's ability to block franchisees from purchasing ingredients from other sources stemmed from its exercise of contractual powers, not market power, and the remedy for this problem lies, if at all, under contract law. The court did not say that as a matter of law the availability of common law remedies prohibits recovery under an antitrust theory. We see no error.

I.

The district court declined to exercise supplemental jurisdiction over the plaintiffs' remaining state law contract claims. This decision is committed to the sound discretion of the district court. *Stehney v. Perry*, 101 F.3d 925, 939 (3d Cir. 1996); *Growth Horizons, Inc. v. Delaware County, Pa.*, 983 F.2d 1277, 1284-85 (3d Cir. 1993). Because all federal claims were correctly dismissed and dismissal of the remaining contract claims would not be unfair to the litigants or result in waste of judicial resources, we see no abuse of discretion.

IV.

For the foregoing reasons, we will affirm the judgment of the district court.

LAY, Circuit Judge, dissenting.

I respectfully dissent.

The district court, at the pleading stage, dismissed plaintiffs' complaint alleging violations under § 1 and § 2 of the Sherman Antitrust Act holding that plaintiffs failed to allege a relevant market. The issue is complex. Judge Scirica's opinion is logically reasoned. Our differences lie in the interpretation and application of the Supreme Court's recent opinion in *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992). I respectfully submit, for the reasons that follow, that the district court's opinion in this case rests on several incorrect hypotheses. To the extent that the majority adopts the district court's rationale, I dissent.

The district court rejected as a matter of law the plaintiffs' alleged relevant market, that of the derivative aftermarket for ingredients and supplies among Domino's Pizza, Inc. ("DPI")'s franchisees. The district court found that "[t]he economic power DPI possesses results not from the unique nature of the product or from its market share in the fast food franchise business, but from the franchise agreement."[1]

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[1] The district court relied on "two influential commentators," Benjamin Klein and Lester F. Saft, *The Law and Economics of Franchise Tying Contracts*, 28 J.L. & Econ. 345, 356 (1985) and two pre-*Kodak* cases, *Mozart Co. v. Mercedes-Benz of*

The plaintiffs allege that DPI has harmed the competitive process by "foreclos[ing] interbrand competition in the market for distributing approved Ingredients and Supplies to Domino's franchisees." The plaintiffs argue that DPI prevented a franchise cooperative and other distributors of ingredients and supplies from entering that market. By stopping any interbrand competition for ingredients and supplies for DPI franchisees, DPI, according to the pleadings, has excluded other potential distributors, and thereby preempted market forces from disciplining the sale of ingredients and supplies.

Interchangeability

In adopting the district court's approach to relevant market definition, the majority reasons that all ingredients and supplies, whether or not approved by DPI, are

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North America, Inc., 833 F.3d 1342 (9th Cir. 1987), and *Tominaga v. Shepherd*, 682 F. Supp. 1489 (C.D. Cal. 1988). The district court adopted the Ninth Circuit's analysis from *Mozart* that an alleged economic-lock-in is irrelevant to the determination of a defendant's market power. *See Tominaga*, 682 F. Supp. at 1494 (quoting *Mozart*, 833 F.2d at 1346-47). This reasoning is simply irreconcilable with the Supreme Court's analysis of information and switching costs in *Kodak*. *See Kodak*, 504 U.S. at 473-77.

It should also be noted Professor Klein recognized, contrary to his original thesis, that *Kodak* permits the recognition of market power in a derivative aftermarket "despite the absence of market power in the equipment market, by taking advantage of imperfectly informed consumers that become 'locked-in' to their existing Kodak equipment." *See* Benjamin Klein, *Market Power in Antitrust: Economic Analysis After Kodak*, 3 Sup. Ct. Econ. Rev. 43, 48 (1993).

interchangeable for making pizzas generally and therefore must be included within the relevant market. Kodak made a similar argument. As in *Kodak*, this ignores the reality that there are no substitutes for ingredients and supplies sold only by DPI. The majority's approach to the interchangeability concept is not faithful to the purpose of interchangeability analysis or the Supreme Court's understanding of market definition and power. The purpose of analyzing interchangeability is to find competing products which are reasonable substitutes and thereby prevent market power.[2] In *Kodak*, the question was whether the cross-elasticity of demand between the equipment market and the derivative aftermarkets for parts and service was sufficient to deprive Kodak of market power. Our question is whether the interchangeability of, or cross-elasticity of demand between, DPI-approved ingredients and supplies and other ingredients and supplies is sufficient to make the alleged relevant market invalid. The issue, whether under the framework of market power as it was in *Kodak*, or as market definition as here, is whether competition from other providers of ingredients and supplies for pizzas will restrain the power of DPI over ingredients and supplies it sells to franchisees. *See Kodak*, 504 U.S. at 469 n.15. The plaintiffs allege not only that they are limited to buying ingredients and supplies from DPI, but also that information and switching costs prevented them from

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[2] The basic definition of market power is "the power to raise prices above competitive levels without losing so many sales that the price increase is unprofitable." Herbert Hovenkamp, *Federal Antitrust Policy: The Law of Competition and its Practice* § 3.1, at 79 (1994) (footnote omitted).

anticipating and being able to respond to DPI's power to substantially raise price for the ingredients and supplies. They allege that competition from independent providers of ingredients and supplies does not restrain DPI's power in the aftermarket for ingredients and supplies, and therefore ingredients and supplies not approved by DPI need not be included in the relevant market.[3]

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[3] The majority, in footnote 17, *ante* at 20, states that the district court's approach has "received support in recent scholarly literature," citing Alan J. Meese, *Antitrust Balancing in a (Near) Coasean World: The Case of Franchise Tying Contracts*, 95 Mich. L. Rev. 111, 128 (1996). However, Professor Meese does not argue that the approach taken is correct under current antitrust law. In fact, on page 126 he concedes that the *Kodak* decision "found that the existence of relationship-specific investments can confer 'market power' ", and at 152-55 he states that "under current law" franchisors may have market power over derivative aftermarkets due to "lock-in" of the franchisees, and because of this he proposes a new framework for analyzing such claims. He argues that "the focus on market power and less restrictive alternatives, though perfectly natural given the partial equilibrium framework that dominates antitrust law and the premises that underlie tying jurisprudence," does not properly apply to the franchise tying context. *Id.* at 128. Professor Meese argues that tying contracts that reduce free riding, a form of opportunistic behavior taken at the expense of the franchise system, should be prima facie legal. Whatever the value of Professor Meese's argument, he presupposes that "under current law" from the Supreme Court the district court in this case may have erred. *Id.* at 152. In addition, it is not even clear that Professor Meese would find the plaintiffs' allegations insufficient as a matter of law because they allege that DPI charged supracompetitive prices for the ingredients and supplies. *See id.* at 155.

Information and Switching Costs

A closely related problem with the district court's opinion is its scant treatment of information and switching costs and their relevance to defining a valid relevant market. The plaintiffs argue that they have experienced information and switching costs which have prevented them from anticipating or responding to the price increases for ingredients and supplies from DPI. They argue that these information and switching costs create a "lock-in" which makes the aftermarket for DPI-approved ingredients and supplies the relevant market. Specifically, the imperfect information they proffer is that the franchisees "could not foresee that Domino's would not follow the policy represented in its Offering Circular and would, instead, commence excluding potential suppliers in order to foreclose competition in the aftermarket." They suggest switching costs arise from sunk costs in the franchise, limits on franchisees's ability to sell their franchise, and noncompetition covenants in the Standard Franchise Agreement.

An important part of the Supreme Court's decision in *Kodak* that the plaintiffs presented a triable claim was that "there is a question of fact whether information costs and switching costs foil the simple assumption that the equipment and service markets act as pure complements to one another." *Kodak*, 504 U.S. at 477. In fact, other circuit courts have held that the presence of these market imperfections was the crucial factor in *Kodak*, and that had Kodak's policy been known at the time businesses bought

copiers from Kodak, the result would have been different.[4] *See PSI Repair Servs., Inc. v. Honeywell, Inc.*, 104 F.3d 811, 820 (6th Cir. 1997) ("We likewise agree that the change in policy in *Kodak* was the crucial factor in the Court's decision. By changing its policy after its customers were 'locked in,' Kodak took advantage of the fact that its customers lacked the information to anticipate this change."), *cert. denied*, 1997 WL 195257; *see also Digital Equip. Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756, 763 (7th Cir. 1996); *Lee v. Life Ins. Co. of North America*, 23 F.3d 14, 20 (1st Cir. 1994). Several commentators have described how the analysis from *Kodak* could mean that franchisors' derivative aftermarkets may be relevant antitrust markets. Meese, 95 Mich. L. Rev. at 152 ("Under current law, [post-contract market power] can arise once the cost to the franchisee of switching to a different franchise is significant. . . . "); Warren S. Grimes, *When Do Franchisors Have Market Power? Antitrust Remedies For Franchisor Opportunism*, 65 Antitrust L.J. 105, 112 (1996) ("A franchisor has market power if it can, without losing substantial sales, raise the price of a good or service sold to a franchisee above the level at which an equivalent good or service is available from other suppliers."); *see*

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[4] This conclusion seems quite sensible. If Kodak customers knew about Kodak's subsequent parts-and-service policy when they bought the copiers, or were not economically restricted from switching to other copiers, then Justice Scalia's dissent, which assumes a perfect competition/perfect information world, should be right. Kodak is merely a concession to fact that markets do not always work perfectly, and sometimes, but not always, these imperfections can create sufficient market power to justify possible antitrust liability.

also Robert H. Lande, *Chicago Takes It On The Chin: Imperfect Information Could Play A Crucial Role In The Post-Kodak World*, 62 Antitrust L.J. 193, 195 (1993) ("Another important lesson of *Kodak* is that imperfect information can be a crucial factor in defining relevant markets."). *But see* Alan Silberman, *The Myths of Franchise "Market Power"*, 65 Antitrust L.J. 181, 217 (1996).

Uniqueness

In rejecting the plaintiffs' theory that the information and switching costs they face justify the alleged relevant market under *Kodak*, the majority states: "*Kodak* does not hold that the existence of information and switching costs alone, such as those faced by the Domino's franchisees, renders an otherwise invalid relevant market valid." *Ante* at 16 (footnotes omitted). Both the district court and the majority make a more difficult argument, that a necessary factor in Kodak was that the repair parts were "unique." They state that this uniqueness is what gave Kodak market power, and that the lack of this factor herein warrants rejecting the plaintiffs' alleged relevant market. The basis for not applying *Kodak* in this case lies in two arguments: (1) the aftermarket ingredients and supplies are not unique, and (2) the franchisees knew of the policy because it was contained in the franchise agreement.

The first argument fails as a matter of law. Whether the product is unique was not the key component of the *Kodak* opinion. Even if the Court was somehow preoccupied with the "uniqueness" of the Kodak replacement parts, the opinion itself as well as economic theory suggest that uniqueness was not a *sine qua non* in finding a

triable claim of market power. Justice Blackmun describes the plaintiffs' allegations regarding the market realities, including the facts that Kodak had excluded independent parts distributors and service competition and then boosted prices above prior levels. After this discussion, Justice Blackmun states: "Under our prior precedents, this evidence would be sufficient to entitle respondents to a trial on their claim of market power." 504 U.S. at 465.[5] The term unique seems to be important for antitrust purposes only in describing a product which has no reasonable substitutes.[6] The fact that Kodak parts were unique was important only because it limited the choices available to Kodak equipment owners seeking to replace worn out parts. The Court stated: "The relevant market for antitrust purposes is determined by the choices available to Kodak equipment owners." 504 U.S. at 481-82. Here, the plaintiffs' choices are limited to DPI-approved ingredients and supplies, and therefore the alleged relevant market is identical in kind to that involved in *Kodak*.

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[5] In *Market Power in Aftermarkets: Antitrust Policy and the* Kodak *Case*, 40 U.C.L.A. L. Rev. 1447 (1993), Professor Hovenkamp argues that whether a product requires "unique" replacement parts is absolutely irrelevant to whether the manufacturer of that product has market power. He states that the portion of the *Kodak* opinion about unique parts is wrong, but that the evidence cited of increased prices was relevant to the question of market power. *Id.* at 1454-55.

[6] For example, if someone patented a new material for bottling soft drinks, it would certainly be true that there were no other materials just like it. But, provided glass and plastic were still reasonable substitutes, the description "unique" would not be meaningful for antitrust analysis.

In *Wilson v. Mobil Oil Corp.*, 940 F. Supp. 944 (E.D. La. 1996), the district court analyzed the relevance of the *Kodak* opinion to the franchise context. The defendants argued that *Kodak* does not apply to the franchisor/franchisee relationship and cited the district court opinion from this case for support. *Wilson*, 940 F. Supp. at 951. The court rejected the argument that the lack of unique products, like Kodak parts, makes *Kodak* inapplicable to the franchise relationship:

> This Court is not convinced that a principled distinction can be drawn as a matter of law between the franchise context and the durable equipment market involved in *Kodak*. No facts have been adduced to indicate that a business format franchise cannot create a derivative aftermarket for the purchase and sale of products that must be used in the franchise operation by the franchise network. Nor have facts been adduced that such an aftermarket could not be subject to the same economic dislocations that permitted market power to be possible in *Kodak*. The *Kodak* court did not purport to base its market power analysis solely on the fact that Kodak's machines were unique, nor did it limit the application of its reasoning to durable equipment markets. If anything, *Kodak* cautions against making economic assumptions on a blank factual record. See *Kodak*, 504 U.S. at 466-67.

Id. at 951-52. This analysis is compelling because it incorporates the understanding that a unique product does not

itself confer market power and then analyzes the workings of the market in question.[7]

The majority also distinguishes *Virtual Maintenance, Inc. v. Prime Computer, Inc.*, 11 F.3d 660 (6th Cir. 1993), on the basis of the importance of a unique product. In *Virtual Maintenance*, the Sixth Circuit was directed by the Supreme Court, in light of its opinion in *Kodak*, to reconsider the Sixth Circuits' earlier rejection of the plaintiff's antitrust claims. Upon reconsideration in light of *Kodak*, the court upheld the alleged relevant market for "the sale of software revisions and support of software necessary to do business with Ford Motor Company." *Id.* at 664 (citation omitted). In upholding the derivative aftermarket as a relevant market, the court held: "Like Kodak, Prime is able to exercise control over the sale of software support because of its exclusive distribution license from Ford, and Ford's requirement that its automotive design

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[7] The majority cities *United Farmers Agents v. Farmers Ins. Exchange*, 89 F.3d 233 (5th Cir. 1996), *cert. denied*, 117 S. Ct. 960 (1997), for the argument that a derivative aftermarket defined by contractual restraints must be rejected. However, this case does not stand for the proposition for which it is cited. In *United Farmers*, the 5th Circuit does cite the statement from Professors Klein and Saft, that the economic power derived from contractual agreements has nothing to do with market power for purposes of antitrust. 89 F.3d at 236-7. However, the court proceeded to expressly address whether there were sufficient information and switching costs to justify invoking *Kodak* and upholding the plaintiffs' alleged relevant market. The district court in *Wilson* addressed the importance of the *United Farmers* opinion and concluded: "If anything, this decision suggests that when parties seek to invoke *Kodak*, issues of information costs and switching costs must be addressed before tying claims can be rejected out of hand." *Wilson*, 940 F. Supp. at 952.

suppliers use the most current version of Prime's software support." *Id.* at 666. The majority in the present case rejects application of *Virtual Maintenance* to this case: "But Prime had a monopoly because it possessed a unique product that no one else sold. Since the product was unique, and not interchangeable with any other products, it constituted its own relevant market for antitrust purposes. By contrast, Domino's does not sell a unique product or service." *Ante* at 18. However, this misstates the facts; Prime's product was not unique. In fact, the plaintiffs in *Virtual Maintenance* made products that were reasonably interchangeable with that of Prime. Thus, this analysis slights the significance of Prime's distribution license from Ford and Ford's requirement that suppliers use the latest version of Prime's product. The Sixth Circuit analyzed the market realities, including evidence of price manipulation and an economic lock-in, and concluded that under *Kodak* the alleged relevant market was valid.

The Franchise Agreement

The second argument, that the alleged relevant market fails because franchisees knew of the policy, fails as a matter of fact. Adopting the district court's position, the majority states that the franchisees knew the potential costs and economic risks of DPI forcing them to buy ingredients and supplies only from DPI at supracompetitive prices because the franchise agreement gave DPI the power to do so. *Ante* at 17. This statement is illusory for two reasons. First, it ignores the information in the Offering Circulars: the plaintiffs are supposed to have anticipated these actions despite the fact that they are directly

contrary to what DPI told them. The plaintiffs argue that the Offering Circulars DPI presented when they were considering a DPI franchise stated that there would be alternative suppliers for the ingredients and supplies. Second, it would be illogical for the franchisees to expect that the franchisor's right to sell ingredients and supplies coupled with its approval power in the franchise agreement, included for the very legitimate purpose of franchise quality control, would be applied in such an odd and predatory way.[8] It seems hard for DPI to argue that the franchise agreement justifies its actions when all it's doing is buying the ingredients and supplies, marking up the prices, and then reselling them to the franchisees.[9]

Conclusion

Concern is expressed about the possible impact on the franchise industry from adopting plaintiffs' theory of relevant market definition. However, plaintiffs still have to prove the arguments they present for the alleged relevant market, and seek more discovery in order to do so. There are many defenses, which have not been argued, which may be applicable in this case or other franchisor/

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[8] It is alleged the DPI's Offering Circular represented to prospective franchisees that DPI would approve a sufficient number of suppliers to ensure a competitive aftermarket for ingredients and supplies, and that it would only utilize its approval power to maintain quality control.

[9] Moreover, the majority's analysis, that what the plaintiffs knew when they entered the franchise agreement is an important distinguishing factor, concedes that imperfect information is a crucial factor in determining relevant market definition.

franchisee antitrust disputes. My main concern with affirming the district court's opinion is the broad rejection of the basis for any antitrust claims by franchisees against franchisors in derivative aftermarkets. *See* Grimes, 65 Antitrust L.J. at 125-26 (describing several types of post-contract franchisor opportunism which may lead to antitrust claims if the franchisor has market power). There may be other problems, which are not before the court, with the plaintiffs' allegations of monopolization and illegal tying in the derivative aftermarkets by a franchisor, but the Supreme Court's clear direction in *Kodak* that information and switching costs are relevant to the ultimate determination of market power is honored by the district court only in the breach. The reality of the aftermarket for ingredients and supplies faced by these plaintiffs, according to the pleadings, is that alternative suppliers do not restrain DPI's ability to increase price, and information and switching costs lock-in the franchisees thereby preventing any competitive response to the price increases from DPI.

For the reasons set forth, I would reverse the district court's 12(b)(6) dismissal of plaintiffs' complaint.

A True Copy:
Teste:

Clerk of the United States Court of Appeals for the Third Circuit

Filed October 27, 1997

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 96-1638

QUEEN CITY PIZZA, INC.; THOMAS C. BOLGER; SCALE PIZZA, INC.; BAUGHANS, INC.; CHARLES F. BUCK; F.M. PIZZA, INC.; ROBERT S. BIGELOW; BLUE EARTH ENTERPRISES, INC.; KEVIN BORES; DAVIS PIZZA ENTERPRISES, INC.; DIANE A. DAVIS; FISHER PIZZA, INC.; JAMES B. FISHER, JR.; SEPCO, INC.; S&S PIZZA CORP.; G&L PIZZA CO.; STEPHEN D. GALLUP; LUGENT PIZZA, INC.; JOSEPH J. LUGENT; BILLIO'S PIZZA, INC.; WILLIAM J. MURTHA; SPRING GARDEN PIZZA, INC.; BRAD L. WALKER; JRW PIZZA, INC.; JAMES R. WOOD, Individually and as Class Representatives of a Class Consisting of All Present and Certain Former Domino's Franchisees in the United States INTERNATIONAL FRANCHISE ADVISORY COUNCIL, INC.

v.

DOMINOS'S PIZZA, INC.

Queen City Pizza, Inc.; Thomas C. Bolger; Scale Pizza, Inc.; Baughans, Inc.; Charles F. Buck; F.M. Pizza, Inc.; Robert S. Gigelow; Blue Earth Enterprises, Inc.; Kevin Bores; Davis Pizza Enterprises, Inc.; Diane A. Davis; Fisher Pizza, Inc.; James B. Fisher, Jr.; SEPCO, Inc.; S&S Pizza, Inc.; G&L Pizza, Inc.; Stephen D. Gallup; Lugent Pizza, Inc.; Joseph J. Lugent; Billio's Pizza, Inc.; William J. Murtha; Spring Garden Pizza, Inc.;

Brad L. Walker; JRW Pizza, Inc.;
James R. Wood; and International
Franchise Advisory Council, Inc.,

Appellants

(D.C. Civ. No. 95-cv-03777)

SUR PETITION FOR REHEARING

Present: SLOVITER, *Chief Judge*,
BECKER, STAPLETON, MANSMANN, GREENBERG,
SCIRICA, COWEN, NYGAARD, ALITO,
ROTH, LEWIS, McKEE and LAY,* *Circuit Judges*

ORDER

The petition for rehearing filed by appellants in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular service not having voted for rehearing, the petition for rehearing by the panel and the Court in banc, is denied. Chief Judge

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* The Honorable Donald P. Lay. United States Circuit Judge for the Eighth Judicial Circuit, who sat by designation, as to panel rehearing only.

Sloviter and Judges Becker, Mansmann, Nygaard and Roth would grant rehearing.

BY THE COURT,

/s/ Anthony J. Scirica

Circuit Judge

Dated: October 27, 1997

BECKER, *Circuit Judge, Statement Sur Denial of the Petition for Rehearing.*

The majority opinion's interpretation of the Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992) has serious consequences for our future examination of franchisor/franchisee relationships in the context of the antitrust laws. The majority states that

> *Kodak* does not hold that the existence of information and switching costs alone, such as those faced by the Domino's franchisees, renders an otherwise invalid relevant market valid.

Queen City Pizza, Inc., et al. v. Domino's Pizza, Inc., No. 96-1638. Slip op. at 16. Instead the majority believes that the *ratio decidendi* of the *Kodak* case is that the aftermarket commodity or service alleged to constitute a single brand market must be unique. Slip op. at 15-16. When this view is combined with the majority's further holding that uniqueness must come from the nature of the product, not the franchise agreement, slip op. at 13-14, the result is that the franchisor/franchisee relationship is rendered virtually immune from antitrust scrutiny.

Judge Lay's splendid dissenting opinion fully exposes the flaws in the majority's relevant product market analysis, and I need not labor the point. I do, however, write separately to elucidate a concern about the majority's approach to antitrust policy in the franchising area that Judge Lay discusses only briefly, slip op. at 34-35, but which also strongly counsels that this case be heard *en banc*.

I have long believed that "The way you come out in [a] case depends on how you go in." *See Larry Muko, Inc. v. Southwestern Pa. Bldg. & Constr. Trades Council*, 609 F.2d 1368, 1377 (3d Cir. 1979) (Aldisert, J., dissenting). The majority's holdings stem, I believe, from how it has gone into the case, i.e. from the fact that the majority has bought into the oft-heard paeans of praise for franchising:

> Franchising is a bedrock of the American economy. More than one third of all dollars spent in retailing transactions in the United States are paid to franchise outlets. We do not believe the antitrust laws were designed to erect a serious barrier to this form of business organization.

Queen City Pizza, Inc., et al. v. Domino's Pizza, Inc., No. 96-1638. Slip op. at 18. It also has endorsed the questionable theory that the kind of tying arrangements involved here "are an essential and important aspect of the franchise form of business organization." *Id.* But these theories are also flawed.

I believe that the approach endorsed by the majority might have been acceptable two decades ago, *see Ungar v. Dunkin' Donuts*, 531 F.2d 1211 (3d Cir. 1976), when franchising was in its nascent, or at least its growing stage.

But now the food franchisors are leviathans, and I am underwhelmed by the suggestion that they may be permitted with impunity to perpetuate the type of arrangements pled in the complaint. These arrangements are clearly quite onerous to the average franchisee, a relatively small business person whose sunk costs in the franchise represent all or most of his or her assets and who lack the considerable resources necessary to switch or defranchise. Moreover, the amount of commerce that the franchisors are foreclosing in the tied product market – for the pizza sauce, flour and other supplies (for which non-franchisor dominated suppliers, be they individual firms or a franchise cooperative, could easily meet quality control specifications) is enormous.

Additionally, to the extent that the plaintiffs have alleged coercion in connection with their acceptance of a burdensome tie, a Rule 12(b)(6) dismissal would be inconsistent with *Ungar*. Indeed, even if the majority's legal position is correct, it can only be sustained if it were an affirmance of a summary judgment on a full record, which is how the opinion seems to read. It can not stand under its actual procedural status – review of a Rule 12(b)(6) dismissal.

For all the foregoing reasons, I dissent from the denial of rehearing *en banc*.

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

QUEEN CITY PIZZA, INC., et al.,	:	
Plaintiffs,	:	
v.	:	No. 95-CV-3777
DOMINO'S PIZZA, INC.,	:	
Defendant.	:	

MEMORANDUM AND ORDER

(Filed April 30, 1996)

Joyner, J.

The plaintiffs in this antitrust action are eleven owners and operators of Domino's Pizza franchises located in Delaware, Florida, Illinois, Minnesota, Mississippi, New Hampshire, North Carolina, Pennsylvania and South Carolina, as well as International Franchise Advisory Council, Inc. ("IFAC"), a Michigan corporation whose members include approximately 40% of the Domino's Pizza franchisees located in the United States. IFAC brings this suit on its own behalf and on behalf of its member franchisees. On September 25, 1995, Plaintiffs filed an amended complaint against Domino's Pizza, Inc. ("DPI"), also a Michigan corporation, seeking (1) declaratory, injunctive and compensatory relief under §§ 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 and 2; and (2) damages for DPI's alleged breach of contract, breach of the implied covenant of good faith and fair dealing, and tortious interference with contractual relations. DPI has since filed the instant motion for summary judgment as to the claims

brought by IFAC in both its individual and representative capacities on the grounds that IFAC lacks standing. Moreover, DPI contends that the breach of contract, breach of covenant of fair dealing, and antitrust claims should be dismissed for failure to state a claim on which relief can be granted. We conclude that the facts set forth in the amended complaint do not give rise to causes of action cognizable under the federal antitrust laws. Accordingly, we will dismiss the anti-trust claims pursuant to Fed. R. Civ. P. 12(b)(6) and dismiss the remaining claims in accordance with Rule 12(b)(1).

FACTUAL BACKGROUND

The facts giving rise to this action, as recited in the amended complaint, are as follows. The Domino's pizza business is comprised of a network of stores that sell pizza and other food products largely on a take-out or delivery basis. The Domino's network consists of approximately 700 stores owned and operated by DPI and 3,500 stores owned and operated by Domino's franchisees. In order to acquire a Domino's franchise, a franchisee must enter into a franchise agreement[1] with DPI, pursuant to which the franchisee is entitled to market food products under DPI's business format and trade and service marks in exchange for franchise fees and royalties. The franchise

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[1] Plaintiffs state that while the terms of the franchise agreement have varied over the years, the material provisions of the franchise agreements at issue here are substantially the same for each of the franchisee plaintiffs. Thus, Plaintiffs refer in their complaint amended to a "Standard Franchise Agreement."

agreement is crafted so as to maintain uniformity and consistency of quality throughout the network. Franchisees must therefore purchase ingredients, materials, and supplies from either DPI or a DPI-approved supplier. The relevant provision of the franchise agreement reads as follows:

> 12.2 Pizza Ingredients, Supplies and Materials. All pizza ingredients, beverage products, cooking materials, containers, packaging materials, other paper and plastic products, utensils, uniforms, menus, forms, cleaning and sanitation materials and other supplies and materials used in the operation of the Store must conform to the specifications established by us [DPI] from time to time. You [franchisee] must use in the operation of the Store boxes, containers and other paper products imprinted with the Marks as prescribed from time to time by us. We may in our sole discretion require that ingredients, supplies and materials used in the preparation, packaging, and delivery of pizza be purchased exclusively from us or from approved suppliers or distributors. Any ingredient, supply or material not previously approved by us as conforming to our specifications and quality standards must be submitted for examination and/or testing prior to use. We reserve the right from time to time to examine the facilities of any approved supplier or distributor, including the commissary, if any, operated by you, and to conduct reasonable testing and inspection of ingredients, materials or supplies to determine whether they meet our standards and specifications. We also reserve the right to charge fees for testing and evaluating proposed suppliers or distributors and examining or inspecting operations and to

> impose reasonable limitations on the number of approved suppliers of any product. Approval of a supplier or distributor may be conditioned on requirements relating to frequency of delivery, standards of service including prompt attention to complaints and the ability to service and supply stores within areas designated by us.

Moreover, DPI is required "to exercise reasonable judgment with respect to all determinations to be made by us under the terms of [the franchise agreement]." Franchise Agreement § 22.9.

The franchisees purchase the great majority of the required ingredients and supplies from Domino's Pizza Distribution Division ("DPDD"), formerly a subsidiary and now a division of DPI. The nub of the amended complaint is that DPI employs the above-quoted franchise agreement provisions unreasonably, so that franchisees are effectively precluded from purchasing ingredients and supplies in a competitive market. For example, Plaintiffs contend that when they initiated efforts to produce fresh pizza dough at the store level, DPI arbitrarily increased the processing fees and altered the standards and inspection practices so as to eliminate any savings the franchisees may have realized, in an effort to protect DPDD from competition. Moreover, the franchisees producing fresh dough in approved commissaries were prohibited by DPI from selling the dough to other franchisees, even though the dough-producing franchisees could deliver the dough to other franchisees at a cost 25% to 40% less than DPDD's price.

In 1993, IFAC began to pursue alternative means of acquiring ingredients and supplies at more competitive

prices for its member franchisees. To that end, IFAC entered into a purchasing affiliation agreement ("purchasing agreement") with FoodService Purchasing Cooperative, Inc. ("FPC") on June 15, 1994. Pursuant to the purchasing agreement, FPC was appointed to act as purchasing agent for the IFAC-member franchisees and to develop a cooperative purchasing plan for franchisees seeking to purchase ingredients and supplies from a source other than DPDD. Plaintiffs contend that once DPI became aware of IFAC's efforts, it initiated a campaign to prevent FPC from establishing a cooperative purchasing program that would compete with DPDD. Thus, when IFAC and FPC requested that DPI provide specifications so that FPC could solicit bids from potential suppliers, DPI eventually issued specifications so vague that suppliers could not furnish FPC with meaningful price quotations. Further, Plaintiffs assert that in response to IFAC and FPC's efforts, DPI entered into exclusive dealing arrangements with a broad base of Domino's franchisees for the purpose of denying FPC a pool of purchasers sufficiently large to make the alternative purchasing effort feasible.

Plaintiffs allege that DPI has engaged in other anti-competitive conduct for the purpose of shielding DPDD from competition. DPI's alleged activity includes: (1) entering into an exclusive dealing arrangement with the only approved supplier of deep-dish pizza crusts, thereby effectively preventing FPC from arranging for the purchase of this ingredient from an alternative source; (2) effectively denying FPC access to approved pizza sauce suppliers and refusing to consider approving a low-cost alternative supplier for many months, even though the

alternative supplier's product met DPI's standards for quality; and (3) commencing a "predatory pricing" effort, whereby DPI lowered prices on most ingredients and supplies to a level competitive with the prices FPC was expected to offer, while raising prices on fresh dough, an ingredient over which DPI maintained almost exclusive control, and tying the purchase of fresh dough to the purchase of other ingredients and supplies.

Finally, Plaintiffs contend that when it solicited them to become Domino's franchisees, DPI represented that DPDD was but one of a number of approved suppliers and that the terms of the franchise agreement would provide for a competitive purchasing environment. They claim that DPI reneged on this promise in the manner described above, forcing them to pay an additional $3,000 to $10,000 per store annually for ingredients and supplies. Moreover, Plaintiffs allege that they are effectively "locked in" to the franchises in view of their investments, and since DPI must approve any sale of a franchise and applies an unreasonably restrictive approval policy. Thus, any franchisee desiring to switch its investment to an alternative franchise system is likely to incur a significant financial loss.

ANALYSIS

A. The Antitrust Claims

As noted above, Plaintiffs seek injunctive relief and treble damages as a result of DPI's alleged violation of §§ 1 and 2 of the Sherman Act. In Count One, Plaintiffs contend that the facts set forth in the amended complaint constitute an unreasonable restraint on trade and a tying

arrangement that is *per se* unlawful under § 1. Plaintiffs allege in Count Two that DPI has unlawfully monopolized the relevant market in violation of § 2. DPI contends that the antitrust claims should be dismissed pursuant to Rule 12(b)(6). Specifically, DPI argues that the amended complaint must be dismissed in light of Plaintiffs' failure to allege a relevant product market, and that to the extent Plaintiffs contend that the relevant market is the market for ingredients and supplies among Domino's franchisees, such a market definition must be rejected as a matter of law. We turn now to evaluate these arguments.

1. Standard of Review

We first address DPI's argument that the antitrust claims should be dismissed on the grounds that Plaintiffs have failed to allege a relevant market. DPI has thus challenged the legal sufficiency of Plaintiffs' antitrust claim. Accordingly, we must examine whether Plaintiffs have set forth facts which state a claim as a matter of law. *Taha v. I.N.S.*, 828 F. Supp. 362, 364 (E.D. Pa. 1993). In so doing, the court must accept as true all of the factual averments in the complaint and extend to the plaintiff the benefit of every favorable inference that can be drawn from those allegations. *Schrob v. Catterson*, 948 F.2d 1402, 1405 (3d Cir. 1991); *Markowitz v. Northeast Lane Co.*, 906 F.2d 100, 103 (3d Cir. 1990). Thus, a complaint is properly dismissed only if it appears certain that the plaintiff cannot prove any set of facts in support of his claim which would entitle him to relief. *Ransom v. Marrazzo*, 848 F.2d 398, 401 (3d Cir. 1988).

2. Relevant Market

As stated above, Plaintiffs allege that DPI's conduct amounts to both an unreasonable restraint of trade and an unlawful tying arrangement under § 1. Section 1 provides that "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C. § 1. A vertical non-price restraint, such as the one at issue in the instant case, is governed by the rule of reason, which requires an examination of whether the restraint had an anti-competitive effect in the relevant market. *Muenster Butane, Inc. v. Stewart Co.*, 651 F.2d 292, 295 (5th Cir. 1981) (citing *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977)).

A plaintiff contending that defendant employed an unlawful tying arrangement must likewise identify the relevant market. A tying arrangement is an agreement by one party to sell a product (the tying product) to a buyer, but only on the condition that the buyer also purchase from the seller a different product (the tied product). *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 461 (1992); *Advo, Inc. v. Philadelphia Newspapers, Inc.*, 854 F. Supp. 367, 377 (E.D. Pa. 1994), *aff'd*, 51 F.3d 1191 (3d Cir. 1995). The "essential characteristic" of a tying arrangement violative of § 1 "lies in the seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have preferred to purchase elsewhere on different terms." *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12 (1984). Thus, there can be no Sherman Act violation in the absence of the

seller's ability to "force" the buyer to act in a manner different from the way he would behave in a competitive market. *Id.* at 13-14. This ability is termed "market power" in the tying market – the ability of the seller to raise price and restrict output. *Kodak*, 504 U.S at 464.

Plaintiffs further contend that DPI is liable under § 2 for its monopolization or attempted monopolization of the relevant market. Section 2 sanctions those "who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations." 15 U.S.C. § 2. In order to sustain a claim for monopolization, a plaintiff must show that the defendant (1) possessed monopoly power in the relevant product and geographic markets; and (2) acquired and maintained that power wilfully, as distinguished from having developed its business as a result of a superior product, business acumen, or historic accident. *Borough of Lansdale v. Philadelphia Elec. Co.*, 692 F.2d 307, 311 (1982) (citing *United States v. Grinnel Corp.*, 384 U.S. 563, 570-71 (1966)). As for attempted monopolization, a plaintiff must show (1) that defendant has engaged in predatory or anti-competitive conduct with (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power, an inquiry requiring an examination of the relevant market and the defendant's ability to affect competition in that market. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993). Monopoly power, like market power in the § 1 context, is generally defined as the ability to control price and exclude competition within the relevant product and geographic markets, and is usually determined by examining the

extent of the alleged monopolist's market share. *Pennsylvania Dental Ass'n v. Medical Serv. Ass'n of Pennsylvania*, 745 F.2d 248, 260 (3d Cir. 1984), *cert. denied*, 471 U.S. 1016 (1985); *Lansdale*, 692 F.2d at 313.

Thus, in order to state a Sherman Act claim under either § 1 or § 2, a plaintiff must identify the relevant product and geographic markets and allege that the defendant exercises market power within those markets. *Brader v. Allegheny General Hosp.*, 64 F.3d 869, 877 (3d Cir. 1995); *Tunis Bros. Co., Inc. v. Ford Motor Co.*, 952 F.2d 715, 726 (3d Cir. 1991), *cert. denied*, 505 U.S. 1221 (1992).[2] The relevant product market is defined as "those 'commodities reasonably interchangeable by consumers for the same purposes.' " *Tunis Bros.*, 952 F.2d at 722 (quoting *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956)). In determining the relevant product market, the court examines the cross-elasticity of demand; that is, the court considers, in light of the product's characteristics and price, the extent to which a rise in price of the product creates a rise in demand for like products in that market. *Id.* The relevant geographic market consists of the area in which customers would look to purchase the product. *Id.* at 726.

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[2] This is not to say that the degree of the defendant's dominance of the relevant market that would trigger liability under § 1 would necessarily raise a § 2 claim. The Supreme Court has long held that "[m]onopoly power under § 2 requires, of course, something greater than market power under § 1." *Kodak*, 504 U.S. at 481 (citing *Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495, 502 (1969)).

While they do not explicitly identify the relevant product and geographic markets in their amended complaint, it is clear from the context, and confirmed in their memorandum in opposition to the instant motion, that Plaintiffs consider the relevant product market to be the market for ingredients and supplies among Domino's franchisees. Further, Plaintiffs argue that the franchisees are "consumers" for purposes of this litigation, and that the relevant geographic market encompasses the entire nation. Thus, in support of its tying claim, for example, Plaintiffs assert that DPI enjoys monopoly power over pizza dough, and uses it both to exclude other potential sellers from the market and to charge super-competitive prices for other ingredients and supplies. Moreover, Plaintiffs allege that DPI possesses monopoly power in the market comprised of Domino's franchisees, and that it improperly uses that power to exclude DPDD's potential competitors from the market.

For its part, DPI contends that as a matter of law, a relevant market cannot arise from a franchise agreement. Thus, this case presents the issue of whether the antitrust laws are implicated where a franchisor dominates a "market" created by virtue of franchise agreements. In the past, courts have concluded that an illegal tying arrangement can arise in the franchise context where franchisees are compelled to purchase equipment or other tied products from the franchisor in order to obtain the franchise. *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704, 722 (7th Cir. 1979), *cert. denied*, 445 U.S. 917 (1980); *Northern v. McGraw-Edison Co.*, 542 F.2d 1336, 1345 (8th Cir. 1976), *cert. denied*, 429 U.S. 1097 (1977); *Siegel v. Chicken Delight*, 448 F.2d 43, 49 (9th Cir. 1971), *cert. denied*, 405 U.S. 955

(1972). In these cases, the courts concluded that the defendants possessed market power as a result of the unique nature of the franchise's trademark, a basis for market power that has since been discredited. *See Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342, 1346 (9th Cir. 1987), *cert. denied*, 488 U.S. 870 (1988) ("[W]hile many individual purchasers of automobiles undoubtedly regard a Mercedes as unique, it is by no means clear that franchisees (dealers) view the Mercedes in the same manner. To them it is an article that is purchased at wholesale and sold at retail."). Still, these cases illustrate the key distinction to be drawn in defining market power in the franchise context: that between a franchisor's pre-contractual market power versus the post-contractual economic power it possesses under the contract. Two influential commentators describe the distinction as follows:

> The important economic distinction that must be made is between pre- and postcontract economic power. Precontract, competition among franchisors (such as McDonald's or Kentucky Fried Chicken) to sign up franchisees prevents [a single franchisor] from exercising any economic power in setting contract terms with potential franchisees. [The franchisor], although it possesses a trademark, does not possess any economic power in the market in which it operates – the fast food franchising (or perhaps, more generally, the franchising) market.
>
> Postcontract, on the other hand, a franchisor can use the threat of termination to "hold up" a franchisee that has made a specific investment in the marketing arrangement. However, *this potential economic power has nothing to do with*

> *market power, ultimate consumers' welfare, or antitrust.*

Benjamin Klein & Lester F. Saft, *The Law and Economics of Franchise Tying Contracts*, 28 J. Law & Econ. 345, 356 (1985) (emphasis added). Thus, market power in the pre-contractual setting derives not from the trademark or from the franchisor's power to award a franchise, but instead focuses on the product, and is defined by the extent to which the franchisor is able to force a potential franchisee to purchase a tied product rather than acquire a franchise to sell a competing brand. *Mozart*, 833 F.2d at 1346.

As we noted above, Plaintiffs here do not allege that DPI enjoyed market power in the fast food franchise business such that it could force potential franchisees to purchase a tied product. Instead, they contend that DPI has employed its contractual power to coerce existing franchisees to purchase ingredients and supplies from DPDD. Accordingly, they assert that the relevant market is the market for ingredients and supplies among Domino's franchisees. The court in *Tominaga v. Shepherd*, 682 F. Supp. 1489 (C.D. Cal. 1988), rejected just such an attempt to define the relevant market in the post-contractual context when presented with facts similar to the ones at issue here:

> Plaintiff's implicit argument is that the relevant market is the "Pizza Man" franchising market. This market definition is erroneous as a matter of law. No reasonable argument can be made that Pizza Man possesses the power to coerce potential franchisees to purchase the tied product rather than sell a different brand of fast food

> (the tying product). The analysis must take place at the "pre-contract" stage. Klein & Saft, *supra*, at 356. Plaintiff, however, engages in "post-contract" analysis concerning defendant's power over already existing franchises by virtue of their "sunk costs." This argument was explicitly rejected in *Mozart*.

Id. at 1494.

We conclude that such reasoning applies here and compels the dismissal of Plaintiffs' antitrust claims. The economic power DPI possesses results not from the unique nature of the product or from its market share in the fast food franchise business, but from the franchise agreement. And as recognized above, allegations of wrongdoing in the postcontractual setting implicate principles of contract, and are not the concern of the antitrust laws. *Id.* at 1495 & n.4. Thus, we must conclude that the relevant market definition Plaintiffs urge in support of their antitrust claims – one that encompasses the market for ingredients and supplies among Domino's franchisees – fails as a matter of law. *See Ajir v. Exxon Corp.*, No. C 93-20830, 1995 WL 429234, at *3 (N.D. Cal. July 7, 1995) ("Just because Exxon's direct serve dealers may contractually purchase gasoline from only one source – Exxon – does not mean that the relevant market is Exxon gasoline."). Moreover, Plaintiffs have failed to allege, and most probably could not allege, that DPI possesses market power such that it could coerce potential franchisees to purchase tied goods against their will. Accordingly, since Plaintiffs have failed to set forth the relevant market, they have failed to plead claims on which relief under the antitrust laws could be granted.

In their effort to defeat the instant motion, Plaintiffs cite the Supreme Court's *Kodak* opinion and argue that (1) a single brand may constitute a market for antitrust purposes and (2) the definition of the relevant market can occur only after the development of a factual record. Such arguments, based upon the mistaken notion that the *Kodak* opinion applies to the instant case, demonstrate the fundamental flaw in Plaintiffs' theory of antitrust liability. In *Kodak*, the plaintiff-repair service organizations alleged that Kodak refused to provide them with specialized replacement parts, thereby forcing Kodak equipment owners to use only Kodak's repair services. In allowing the plaintiffs' claims to go forward, the Court rejected Kodak's argument that a single brand or product can never be a relevant market for antitrust purposes, holding that, under certain circumstances, "one brand of a product can constitute a separate market." *Kodak*, 504 U.S. at 482. Unlike the present case, however, the service market for Kodak equipment arose due to the unique nature of the Kodak machines, and not by virtue of a valid and binding franchise agreement. And as we have concluded above, antitrust claims predicated upon a "relevant market" defined by the bounds of a franchise agreement are not cognizable. Thus, the amended complaint fails not because the purported relevant market arises from a single brand of a product, but because the "market" was created by virtue of the franchise agreements Plaintiffs freely entered.

More importantly, the *Kodak* Court noted that the relevant market inquiry primarily considers the choices available to the ultimate consumer: "The relevant market

for antitrust purposes is determined by the choices available to Kodak equipment owners." *Id.* at 481-82. Such an approach recognizes that the antitrust laws were enacted not to bolster individual firms, but "to protect the competitive process in order to help individual consumers by bringing them the benefits of low, economically efficient prices, efficient production methods and innovation." *Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792, 794 (1st Cir. 1988). Indeed, our Court of Appeals has held that no antitrust action may lie in the absence of harm to competition. *See Tunis Bros*, 952 F.2d at 728 (ordering judgment n.o.v. in favor of defendants on the grounds that plaintiffs failed to show injury to competition).

Plaintiffs' route around this bedrock premise of antitrust law is to assert in their memorandum that *they* are consumers, so that the relevant market should be defined with respect to the choices available to them. This assertion is belied by the amended complaint, of course, which reveals that Plaintiffs are in fact competitors "in the highly competitive retail food service market" who sell food products *to* consumers. Am. Compl. ¶ 25. As for competition generally, the *raison d'etre* of antitrust law, Plaintiffs have failed to assert that any harm has resulted from DPI's alleged conduct. There are no allegations in the amended complaint relating to higher prices or restricted choice at the consumer level. Indeed, while Plaintiffs allege that DPI's actions have caused the franchisees to pay an additional $3,000 to $10,000 for ingredients and supplies per year, they concede in their memorandum that competition generally has not been harmed. Plaintiffs' theory of antitrust liability, in their words, "does not follow a single pizza to its ultimate

consumer." Pls.' Memo. at 21. And as the axiom goes, antitrust laws exist to protect competition, not competitors. Thus, for this reason as well, Plaintiffs' antitrust claims must be dismissed.

B. The Pendent Claims

Having determined that Plaintiffs' federal antitrust claims must be dismissed, we now conclude that the pendent claims should be dismissed pursuant to Rule 12(b)(1) for want of jurisdiction over the subject matter. First, since both DPI and IFAC are citizens of Michigan, we cannot exercise our diversity jurisdiction over the amended complaint. 28 U.S.C. § 1332. *See Stanley v. Exxon Corp.*, 824 F. Supp. 52, 53 (E.D. Pa. 1993) ("complete" diversity is required before court may exercise jurisdiction pursuant to § 1332). Moreover, although Plaintiffs have brought a claim under the Declaratory Judgment Act, 28 U.S.C. § 1332, that statute merely provides a means of relief for aggrieved persons, and does not itself confer jurisdiction. *Gruntal & Co., Inc. v. Steinberg*, 854 F. Supp. 324, 332 (D. N.J.), *aff'd without op.*, 46 F.3d 1116 (3d Cir. 1994). Finally, we are aware of no "special circumstances" that would justify the invocation of our supplemental jurisdiction. *Shaffer v. Board of School Directors*, 730 F.2d 910, 912 (3d Cir. 1984). Accordingly, Plaintiffs' pendent claims will be dismissed without prejudice. *See TM Marketing, Inc. v. Art & Antiques Assocs., L.P.*, 803 F. Supp. 994, 997 (D. N.J. 1992) ("when it becomes apparent that

subject matter jurisdiction is lacking, the court must dismiss the action regardless of the stage of the litigation.").[3]

CONCLUSION

Since the relevant market on which Plaintiffs' antitrust claims are premised – that created by the power DPI exercises pursuant to the franchise agreement – cannot support those claims as a matter of law, and because Plaintiffs have alleged that harm has been visited only upon themselves and not upon competition generally, Plaintiffs have failed to state claims on which relief under the antitrust laws can be granted. Moreover, Plaintiffs' remaining claims must be dismissed pursuant to Rule 12(b)(1). In view of the conclusions we have reached above, we need not address the remaining issues raised in DPI's motion. An appropriate order follows.

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[3] We will allow Plaintiffs to file a second amended complaint that cures the amended complaint's jurisdictional defects within fourteen days of the date of the attached order.

IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

QUEEN CITY PIZZA, INC., et al.,	:	
Plaintiffs,	:	No. 95-CV-3777
v.	:	
DOMINO'S PIZZA, INC.,	:	
Defendant.	:	

ORDER

AND NOW, this 30th day of April, 1996, upon consideration of Defendant's Motion for Partial Summary Judgment and to Dismiss, and the Response thereto, it is hereby ORDERED that said Motion is GRANTED in part as follows:

1. Counts One, Two, and Three of Plaintiffs' Amended Complaint are hereby DISMISSED WITH PREJUDICE;

2. Count Seven of Plaintiffs' Amended Complaint is hereby DISMISSED WITH PREJUDICE to the extent it seeks declaratory relief under federal antitrust laws; and

3. The remaining counts of Plaintiffs' Amended Complaint are hereby DISMISSED WITHOUT PREJUDICE.

Plaintiffs may file a Second Amended Complaint within fourteen (14) days of the date of this Order.

BY THE COURT:

/s/ J. Curtis Joyner, J.
J. Curtis Joyner, J.

Exhibit 1

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

QUEEN CITY PIZZA, INC., et al.,	:	
Plaintiffs,	:	No. 95-CV-3777
v.	:	
DOMINO'S PIZZA, INC.,	:	
Defendant.	:	

ORDER

AND NOW, this 12th day of July, 1996, upon consideration of Plaintiffs' Motion for Leave to File Second Amended Complaint, Defendant's Response, and Plaintiffs' Reply thereto, it is hereby ORDERED that said Motion is DENIED.

The decision to grant or deny a motion for leave to amend a pleading rests within the trial court's discretion. *Dole v. Arco Chem. Co.*, 921 F.2d 484, 486 (3d Cir. 1990); *Mowze v. Jones & Laughlin Steel Corp.*, 750 F.2d 1208, 1212 (3d Cir. 1984). Pursuant to the Federal Rules, the general rule is that "leave shall be freely given when justice so requires." Fed. R. Civ. P. 15(a). Thus, Rule 15(a) "embodies a liberal approach to amendment," *Dole*, 921 F.2d at 486-87; *see Long v. Lipkins*, 96 F.R.D. 234, 234 (E.D. Pa. 1983) (noting that a court's Rule 15(a) discretion "should be generally exercised in favor of Amendment"). As our Court of Appeals has noted, however, the policy favoring liberal amendment of a pleading is not unbounded. *Dole*, 921 F.2d at 487. Indeed, the court

should deny a Rule 15(a) motion if the proposed amended complaint would not survive a motion to dismiss. *Cundlach v. Reinstein*, 924 F. Supp. 684, 690 (E.D. Pa. 1996).

On April 20, 1996, this Court issued a Memorandum and Order dismissing Plaintiffs' federal antitrust claims pursuant to Fed. R. Civ. P. 12(b)(6) and dismissing without prejudice Plaintiffs' pendant claims pursuant to Rule 12(b)(1). *Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 922 F. Supp. 1055 (E.D. Pa. 1996). We rejected Plaintiffs' antitrust claims on two grounds. First, we held that the relevant market on which Plaintiffs' antitrust claims were premised – the market for ingredients and supplies among Domino's franchisees – could not support the antitrust claims as a matter of law. *Id.* at 1062. We further concluded that the antitrust claims had to be dismissed in light of Plaintiffs' failure to allege harm to competition. *Id.* at 1063.

By the instant motion, Plaintiffs ask the Court to allow them to re-plead their antitrust claims. They have submitted a proposed Second Amended Complaint crafted to address the rationale supporting our decision. With respect to our latter concern, Plaintiffs' proposed Second Amended Complaint alleges that harm will be visited upon consumers as a result of Defendants' alleged conduct. As for the primary issue, however, Plaintiffs insist that the Supreme Court's decision in *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 112 S.Ct. 2072 (1992), sanctions the sort of relevant market on which they seek to base their antitrust claims.

In addressing Plaintiffs' antitrust claims in our April 30 Memorandum, we formed the issue as "whether the antitrust laws are implicated where a franchisor dominates a 'market' arrested by virtue or franchise agreements." *Queen City*, 922 F. Supp. at 1041. We answered this question by examining decisions in antitrust cases brought by franchisees, such an *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342 (9th Cir. 1987), *cert. denied*, 488 U.S. 870 (1988), and *Tominaga v. Shepherd*, 682 F. Supp. 1499 (C.D. Cal. 1988). In those cases, the courts recognized the importance of analyzing the relevant market in the pre-contract context, and rejected the very argument that Plaintiffs advance here: "Plaintiff, however, engages in 'post-contract' analysis concerning defendant's power over already existing franchisees by virtue of their 'sunk costs.' This argument was explicitly rejected in *Mozart*." *Tominaga*, 682 F. Supp. at 1494.

Plaintiffs contend that the *Kodak* decision essentially overruled the conclusions reached by the *Mozart* and *Tominaga* courts as to the issue of whether a relevant market can arise as a result of the power a franchisor possesses over a franchisee by virtue of the franchisee's sunk costs. According to Plaintiffs, the *Kodak* Court held that market power can exist in an after-market even in the absence of market power in the pre-market, as long as consumers are "locked-in" as a result of significant switching costs. Thus, Plaintiffs allege that they have made significant investments in their franchisees, and are "looked-in" by their investment as a result of: (1) the long-term franchise agreements they entered; and (2) their contractual obligation to sell their franchises only to buyers approved by Defendant. Proposed Second Am.

Compl. ¶ 61. They contend that this alleged lock-in is sufficient to give rise to a relevant market on which they may base their antitrust claims.

Upon careful re-examination of the *Kodak* opinion, however, we remain unpersuaded by Plaintiffs' line of argument. As we remarked in our April 30 Memorandum, the *Kodak* Court concluded that the relevant market arose from the unique nature of the Kodak machines, and not, as Plaintiffs contend, by virtue of the fact that Kodak equipment owners were locked-in to their investment. The Supreme Court explicitly held that "[b]ecause service and parts for Kodak equipment are not interchangeable with other manufacturer's service and parts, the relevant market from the Kodak-equipment owner's perspective is composed of only those companies that service Kodak machines." *Kodak*, 112 S. Ct. at 2090. The Supreme Court employed the lock-in argument not to define the relevant market, as Plaintiffs insist, but merely to refute Kodak's contention that a lack of market power in the pre-market for equipment necessarily precluded market power in the after-markets for parts and service. *Id.* at 2087. Thus, the analogy Plaintiffs envision between their case and *Kodak* unravels at the outset.

The relevant market in *Kodak* was defined with respect to the choices available to Kodak equipment owners. *Id.* at 2090. The *Kodak* plaintiffs were able to clear the summary judgment hurdle with regard to the market power issue because they had presented sufficient evidence to show that Kodak controlled the papers market for Kodak machines. *Id.* at 2081. Kodak equipment

owners could not purchase parts from rival manufacturers because the parts produced by Kodak's competitors were not compatible with Kodak machines. They had little choice but to purchase parts and service from Kodak, since parts and service were unavailable elsewhere.

By contrast, Plaintiffs here make no allegation that Defendant controls the market for pizza supplies. Indeed, Plaintiffs concede that there are other suppliers in the market from which they could acquire the ingredients they need to produce the pizzas and other food products they sell. Plaintiffs do not and cannot purchase ingredients and supplies from alternative suppliers not because Defendant dominates the ingredient and supply market or because Defendant is the market's only supplier, but because the franchisee-plaintiffs are contractually bound to purchase only from suppliers approved by Defendant. It is economic power resulting from the franchise agreement, therefore, and not market power, that defines the "relevant market" Plaintiffs allege in support of their antitrust claims. Thus, since the Kodak case concerned allegations of unreasonable restraints within a market dominated by Kodak, it does nothing to undercut the rationale supporting *Mozart* and *Tominaga*, which rejected relevant markets predicated upon a franchisor's economic power over a franchisee.

Accordingly, we remain convinced that *Kodak* has little applicability harm. Plaintiffs have still failed to allege a relevant market that concerns antitrust:

> [Franchisor's] ability to "coerce" its franchisees to purchase a product it may not wish to purchase (post-contract), and its claimed ability to

> raise prices because of the franchisees [sic] sunk investment, does not show market power in the fast food franchising market. The "power" exercised is merely the power of a franchiser over its franchisees.

Tominaga, 682 F. Supp. at 1495.

We therefore conclude that Plaintiffs' proposed Second Amended Complaint could not survive a motion to dismiss; and as a result, we must deny Plaintiffs' Rule 15(a) motion.

This action is hereby DISMISSED with prejudice.

BY THE COURT:

/s/ J. Curtis Joyner
J. Curtis Joyner, J.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF PENNSYLVANIA

QUEEN CITY PIZZA, INC., et al.,	)	
Plaintiffs	)	Civil No. 95-CV-3777
vs.	)	JURY TRIAL DEMANDED
DOMINO'S PIZZA, INC.,	)	
Defendant.	)	

SECOND AMENDED COMPLAINT

All Plaintiffs except Plaintiff International Franchise Advisory Council, Inc. bring this action against Defendant Domino's Pizza, Inc. ("DPI") for damages and other relief based on violations of Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§1 and 2; Section 3 of the Clayton Act, 15 U.S.C. §14; breach of contract; and breach of the implied covenant of good faith and fair dealing.

Plaintiff International Franchise Advisory Council, Inc. ("IFAC") brings this action on behalf of itself and its member Domino's franchisees for declaratory and injunctive relief and money damages, based upon DPI's actions and omissions constituting violations of Sections 1 and 2 of the Sherman Antitrust Act, 15 U.S.C. §§1 and 2; Section 3 of the Clayton Act, 15 U.S.C. §14; breach of contract; breach of the implied covenant of good faith and fair dealing; and tortious interference with contractual and prospective economic relations.

Jurisdiction and Venue

1. Subject matter jurisdiction with respect to Counts One, Two, and Three are conferred upon this Court by Sections 4 and 16 of the Clayton Act, 15 U.S.C. §§15 and 26, and by 28 U.S.C. §§1331 and 1337. Subject matter jurisdiction over Counts Four, Five, and Six are conferred by 28 U.S.C. §1332, the diversity of citizenship statute, and by 28 U.S.C. §1367, the supplemental jurisdiction statute. Subject matter jurisdiction over Count Seven, Plaintiffs' claim for declaratory judgment under 28 U.S.C. §2201, is conferred by 28 U.S.C. §§1331, 1332, 1337 and 1367.

2. Venue is proper in this District under the general venue provisions of 28 U.S.C. §1391 and the special venue provisions of Sections 4, 12 and 16 of the Clayton Act, 15 U.S.C. §§15, 22 and 26, in that Defendant DPI may be found and transacts business in this District and a substantial part of the events or omissions giving rise to the claims occurred in this District.

Parties

3. Plaintiff Queen City Pizza, Inc., a Pennsylvania corporation, owns and operates three Domino's pizza stores in Allentown, one Domino's pizza store in West Lawn, one Domino's pizza store in Emmaus, one Domino's pizza store in Reading, one Domino's pizza store in Whitehall, and one Domino's pizza store in Northampton, Pennsylvania. The controlling shareholder of this corporation and the individual Domino's franchisee for these Stores is Thomas C. Bolger. These two Plaintiffs

are sometimes referred to collectively as "the Bolger Plaintiffs".

4. Plaintiff Scale Pizza, Inc., a Pennsylvania corporation, owns and operates three Domino's pizza stores in Bethlehem, Pennsylvania. Plaintiff Baughans, Inc., a Pennsylvania corporation, owns and operates one Domino's pizza store in East Stroudsburg, Pennsylvania. The controlling shareholder of these two corporations and the individual Domino's franchisee for these two stores is Plaintiff Charles F. Buck. These plaintiffs are sometimes referred to collectively as "the Buck Plaintiffs".

5. Plaintiff F.M. Pizza, Inc., a Florida corporation, owns and operates five Domino's pizza stores in Ft. Myers, one Domino's pizza store in North Ft. Myers, one Domino's pizza store in Bonita Springs, one Domino's pizza store in San Carlos, one Domino's pizza store in Lehigh, and one Domino's pizza store in Fort Myers Beach, Florida. The controlling shareholder of this corporation and the individual Domino's franchisee for these Stores is Robert S. Bigelow. These two Plaintiffs are sometimes referred to collectively as "the Bigelow Plaintiffs".

6. Plaintiff Blue Earth Enterprises, Inc., a Minnesota corporation, owns and operates two Domino's pizza stores in Mankato, one Domino's pizza store in St. Peter, one Domino's pizza store in New Ulm, and one Domino's pizza store in Waseca, Minnesota. The controlling shareholder of this corporation and the individual Domino's franchisee for these Stores is Plaintiff Kevin Bores. These two Plaintiffs are sometimes referred to collectively as "the Bores Plaintiffs".

7. Plaintiff Davis Pizza Enterprises, Inc., a Mississippi corporation, owns and operates Domino's pizza stores in Oxford, Senatobia and Southaven, Mississippi and a Domino's "Pizza Pizzazz" Store in Olive Branch, Mississippi. The controlling shareholder of this corporation and the individual Domino's franchisee for these Stores is Plaintiff Diane A. Davis. These two Plaintiffs are sometimes referred to collectively as "the Davis Plaintiffs".

8. Plaintiff Fisher Pizza, Inc., an Illinois corporation, owns and operates five Domino's pizza stores in Chicago, Illinois. The controlling shareholder of this corporation and the individual Domino's franchisee for these Stores is Plaintiff James B. Fisher, Jr. These two Plaintiffs are sometimes referred to collectively as "the Fisher Plaintiffs".

9. Plaintiff Sepco Pizza, Inc., a New Hampshire corporation, owns and operates a Domino's pizza store in Portsmouth, a Domino's pizza store in Manchester, and a Domino's pizza store in Dover, New Hampshire. S & S Pizza Corp., a New Hampshire corporation, owns and operates a Domino's pizza store in Manchester, New Hampshire. G & L Pizza Co., a New Hampshire corporation, owns and operates a Domino's pizza store in Manchester and a Domino's pizza store in Hudson, New Hampshire. The controlling shareholder of these corporations and the individual Domino's franchisee for these Stores is Plaintiff Stephen D. Gallup. These four Plaintiffs are sometimes referred to collectively as "the Gallup Plaintiffs".

10. Plaintiff Lugent Pizza, Inc., a South Carolina corporation, owns and operates Domino's pizza stores in

Darlington and Hartsville, South Carolina. The controlling shareholder of this corporation and the individual Domino's franchisee for these stores is Plaintiff Joseph J. Lugent. These two plaintiffs are sometimes referred to collectively as "the Lugent Plaintiffs".

11. Plaintiff Billio's Pizza, Inc., a Minnesota corporation, owns and operates one Domino's pizza store in Hutchinson, Minnesota. The controlling shareholder of this corporation and the individual Domino's franchisee for this Store is Plaintiff William J. Murtha. These two Plaintiffs are sometimes referred to collectively as "the Murtha Plaintiffs".

12. Plaintiff Spring Garden Pizza, Inc., a North Carolina corporation, owns and operates eight Domino's pizza stores in Greensboro, North Carolina. The controlling shareholder of this corporation and the individual Domino's franchisee for these Stores is Plaintiff Brad L. Walker. These two plaintiffs are sometimes referred to collectively as "the Walker Plaintiffs".

13. Plaintiff JRW Pizza, Inc., a Delaware corporation, owns and operates three Domino's pizza stores in Dover, one Domino's pizza store in Smyrna, one Domino's pizza store in Georgetown, and one Domino's pizza store in Rehoboth Beach, Delaware. The controlling shareholder of this corporation and the individual Domino's franchisee for these Stores is Plaintiff James R. Wood. These two plaintiffs are sometimes referred to collectively as "the Wood Plaintiffs".

14. The Plaintiffs referred to in paragraphs three through thirteen of the Complaint are sometimes referred to collectively as "the Franchisee Plaintiffs".

15. Plaintiff IFAC is a membership corporation organized under the laws of Michigan with its principal place of business in Scottsdale, Arizona. Its members are Domino's franchisees located throughout the United States. The purpose of IFAC is to promote and foster the interests of Domino's franchisees. To that end, IFAC has sought to develop alternative purchasing sources for Domino's franchisees to assist them in obtaining goods and services needed in their businesses at competitive prices. Pursuant to that objective, IFAC entered into a Purchasing Affiliation Agreement with FoodService Purchasing Cooperative, Inc. ("FPC") on June 15, 1994 to obtain purchasing services for IFAC members and other Domino's franchisees at competitive prices on a cooperative basis.

16. Defendant DPI is a Michigan corporation with its principal place of business in Ann Arbor, Michigan. DPI is registered to do business in the Commonwealth of Pennsylvania and transacts business throughout the United States, including the Eastern District of Pennsylvania.

Factual Allegations

17. The Domino's pizza and food service business includes a nationwide and international system of stores (collectively, "Domino's Stores" or the "Domino's System") selling pizza and other food and beverage products to consumers primarily through delivery and carry-out service. In the territorial United States, DPI owns and operates approximately 700 stores while Domino's franchisees own and operate approximately 3500 stores. Sales

of pizza and other products by Domino's Stores in the aggregate exceed $1.8 billion annually in the United States, and the Domino's System is reported to be the second-largest seller of pizza in the United States.

18. Unlike some franchise businesses that promote a "secret recipe" to foster consumer appeal of a unique product, the Domino's System has developed its market on the basis of a business format specializing in fast delivery and made-on-the-premises pizza and other food products. The Franchise Offering Circular for Prospective Franchisees in use by DPI on June 5, 1992 described the business franchise opportunity as follows:

> We have developed a method of preparing pizza and stores which specialize in the sale of such pizza, feature carry out and delivery services and operate with a uniform business format, specially designed equipment, methods, procedures and designs. We grant to certain qualified persons the right to own and operate a DOMINO's PIZZA Store selling pizza through pick-up and delivery service and other approved products pursuant to the terms of our Standard Franchise Agreements.

19. DPI uses its offering circulars, franchise agreements and other advertising to market franchises, distribute products, and receive franchise fees, royalties and payments for goods and services from franchisees in interstate commerce throughout the United States.

20. In order to conduct business in the Domino's business format using the Domino's trade name, trademarks and service marks, each franchisee must enter into a "Standard Franchise Agreement" with DPI. A typical

form Standard Franchise Agreement is attached hereto as Exhibit A. The Standard Franchise Agreement grants Franchisees the right to use DPI's business format and its trade and service marks to prepare and sell pizza, chicken wings, submarine sandwiches, and other food and drink products in accordance with procedures, product specifications, and quality control standards prescribed by DPI. Although the form of the Standard Franchise Agreement used by DPI has varied somewhat over the years, the material provisions of the Standard Franchise Agreements at issue in this case are substantially the same for all Franchisee Plaintiffs.

21. The Standard Franchise Agreement obligates DPI to act reasonably in performing under and enforcing the Agreement. Section 22.9 of the Agreement provides as follows:

> *Standard of Reasonableness.* Unless otherwise stated in this Agreement, we agree to exercise reasonable judgment with respect to all determinations to be made by us under the terms of this Agreement.

22. The Standard Franchise Agreement requires that ingredients used to make pizzas and other food items in Domino's Stores as well as beverage products, cooking materials, containers, packaging materials, other paper and plastic products, utensils, uniforms, menus, business forms, cleaning and sanitation materials and other supplies and materials purchased by franchisees for use in their Stores (collectively, "Ingredients and Supplies") conform to specifications and standards prescribed by DPI, purportedly to ensure consistency and quality throughout the Domino's System.

23. In addition to prescribing specifications and standards for Ingredients and Supplies, the Standard Franchise Agreement gives DPI the power to control the sources from which Domino's franchisees may purchase Ingredients and Supplies, as well as materials and distribution services by limiting such sources to DPI itself or a supplier or distributor approved in advance by DPI. Section 12.2 of the Standard Franchise Agreement provides as follows:

> 12.2 *Pizza Ingredients and Supplies and Materials.* All pizza ingredients, beverage products, cooking materials, containers, packaging materials, other paper and plastic products, utensils, uniforms, menus, forms, cleaning and sanitation materials and other supplies and materials used in the operation of the Store must conform to the specifications and quality standards established by us [DPI] from time to time. You [franchisee] must use in the operation of the Store boxes, containers and other paper or plastic products imprinted with the Marks as prescribed from time to time by us. *We may in our sole discretion require that ingredients, supplies and materials used in the preparation, packaging, and delivery of pizza be purchased exclusively from us or from approved suppliers or distributors.* Any ingredient, supply or material not previously approved by us as conforming to our specifications and quality standards must be submitted for examination and/or testing prior to use. We reserve the right from time to time to examine the facilities of any approved supplier or distributor, including the commissary, if any, operated by you, and to conduct reasonable testing

> and inspection of ingredients, materials or supplies to determine whether they meet our standards and specifications. *We also reserve the right* to charge fees for testing and evaluating proposed suppliers or distributors and examining or inspecting operations and to *impose reasonable limitations on the number of approved suppliers or distributors of any product.* Approval of a supplier or distributor may be conditioned on requirements relating to frequency of delivery, standards of service including prompt attention to complaints and the ability to service and supply Stores within areas designated by us.

(emphasis added).

24. DPI has used these provisions and other provisions of the Standard Franchise Agreement in an unreasonable manner to restrict the ability of Domino's franchisees to purchase Ingredients and Supplies competitively. By virtue of the control it has exercised over the availability of Ingredients and Supplies, DPI is the dominant supplier and dominant distributor of Ingredients and Supplies to the Domino's franchisees, including the Franchisee Plaintiffs. Domino's Pizza Distribution Division ("DPD"), now a division of DPI, was a separately incorporated subsidiary of DPI until 1993. As a subsidiary and then as a Division of DPI, DPD has been the dominant seller of Ingredients and Supplies to the Domino's System for many years. DPD's sales to the system are estimated to be approximately $500 million annually, and represent more than 90 percent of the purchases of Ingredients and Supplies, made by Domino's franchisees, including the Franchisee Plaintiffs, in the operation of their stores.

25. In some comparable food service franchise systems, the franchisees purchase all or most of the ingredients, supplies and materials that they use in their franchise businesses from suppliers and distributors approved by, but independent of, the franchisor. In other such systems, the franchisees purchase their ingredients, supplies, materials and distribution services collectively through purchasing cooperatives. For example, many franchisees of the Kentucky Fried Chicken, Taco Bell, Dairy Queen and Long John Silver franchise systems obtain competitive purchasing services from FoodService Purchasing Cooperative, Inc. ("FPC"), a franchisee-owned cooperative that was organized by Kentucky Fried Chicken franchisees in 1978 and commenced operations in 1980.

26. FPC negotiates directly with franchisor-approved product suppliers and distributors on behalf of these franchise system franchisees to obtain competitively priced ingredients, supplies, materials and distribution services for the franchisees. Such cooperative purchasing arrangements permit economies of scale and other efficiencies in franchisee purchasing and distribution, thereby increasing competition in the market for Ingredients and Supplies, and thus substantially lowering supply and distribution costs for the individual franchisees, permitting them to compete more effectively for customers in the retail food service market.

27. Most if not all of these other franchise system purchasing arrangements are subject to franchisor quality control and specification requirements similar to those reasonably contemplated by the DPI Standard Franchise Agreement. Reasonable franchisor quality control and

specification requirements are easily satisfied in franchisee cooperative and independent purchasing arrangements. FPC, for example, is able to purchase food products and supplies that meet or exceed the product specification and quality control requirements of four major food service system franchisors, at significant cost savings to the franchisees of those systems.

28. Through unreasonable determinations regarding the source and quality control provisions of the Standard Franchise Agreement, and through willful misuse of its economic power as the dominant supplier of Ingredients and Supplies to Domino's franchisees, DPI has effectively prevented Domino's franchisees, including the Franchisee Plaintiffs' from purchasing the Ingredients and Supplies used in their franchise businesses from any source other than DPD, has created significant barriers to any new competitor entering the market for supplying such goods and services to Domino's franchisees' has thwarted IFAC's efforts to implement a cooperative purchasing arrangement through FPC to supply such goods and services at competitive prices, and has substantially foreclosed competition in the supply of Ingredients and Supplies to Domino's franchisees. Its actions have forced Domino's franchisees, including the Franchisee Plaintiffs, to pay higher than competitive prices for Ingredients and Supplies almost exclusively from DPD.

29. In addition to the misuse of its contractual power by making unreasonable determinations not to approve additional suppliers of Ingredients and Supplies, DPI has made willful misuse of its economic power as the

dominant supplier of Ingredients and Supplies to foreclose competition in that market. Whenever DPI has perceived possible entrants in the market for supplying Ingredients and Supplies to Domino's franchisees, DPI has manipulated its prices for Ingredients and Supplies to lessen the franchisees' demand for competing suppliers or create barriers to entry into the market for competing suppliers, or both, as alleged in more detail below.

30. Pizza dough is a primary ingredient used in Domino's Stores, and DPI is both the dominant supplier of dough to Domino's franchisees and the dominant producer of fresh dough in the United States. DPI's dominance of franchisee dough purchases results in part from its willful misuse of its control over dough manufacture, and is a significant source of the control DPI exercises over all franchisee purchasing. The pizzas sold in Domino's Stores are made from three alternative crusts: original crust, thin crust and deep dish crust. The original formula hand-tossed crusts are made from fresh dough balls, while thin crust and deep dish pizzas are made using "parbaked" (pre-formed and partially pre-cooked) shells. Together, fresh dough and parbaked crust shells account for approximately 25 percent of the Ingredient purchase costs, and approximately 15 percent of the total costs for Ingredients and Supplies typically incurred by a Domino's franchisee in the operation of a Domino's Store. The average Domino's Store pays approximately $28,000 for dough products each year, of which approximately 60 percent is accounted for by purchases of fresh dough.

31. DPI controls the manufacture of fresh dough by providing specifications to its operating division, DPD. Consequently, DPD is the largest, and almost the only,

source of fresh dough for the Domino's System. Although some franchisees have commissaries in which they make fresh dough for their own restaurants, more than 90 percent of the fresh dough used in the Domino's System is supplied by DPI through DPD. All of the fresh dough used by the Franchisee Plaintiffs is supplied by DPI through DPD.

32. With respect to the supply of fresh dough, DPI's unreasonable and anticompetitive conduct has taken many forms. Except as noted below, DPD is the only approved supplier of fresh dough for the Domino's System. Historically DPI has refused to allow any third party to manufacture fresh dough for use in the Domino's System.

33. DPI has based its refusal to authorize other competent manufacturers to make dough for use in the Domino's System on its assertion that the quality of the dough would not be adequately controlled and would lead to inconsistency in the system. DPI has made this assertion despite its knowledge that DPD itself has used and is using many different fresh dough formulas, and that monitoring the quality of experienced third-party manufacturers would be no more difficult and no less effective than monitoring the quality of franchisee commissaries.

34. IFAC and other representatives of the Domino's franchisees have encouraged several competent and experienced baked goods manufacturers to seek DPI approval as fresh dough suppliers to the Domino's System. However, DPI has acted to deter such potential suppliers from making the investment to increase their capacity that would be necessary to compete with DPD in

supplying fresh dough to franchisees. For example, simultaneously with an announcement that it would be willing to approve third-party producers of fresh dough, DPI announced that a development project for a frozen alternative to fresh dough would be completed in approximately nine months, and that DPI would then be approving outside suppliers to produce the frozen dough.

35. In the same communication, DPI also announced a "strong desire" to develop a parbake substitute for fresh dough, and that it was "awaiting a proposal from a leader in the baking industry" regarding the parbake alternative. These announcements have had the intended effect of deterring potential new suppliers of fresh dough from even considering making the substantial up-front capital investment that would be necessary to supply "original crust" fresh dough to a substantial portion of the Domino's System.

36. The most likely competitors to DPD in the supply of fresh dough are the Domino's franchisees themselves. The Standard Franchise Agreement allows a franchisee to make dough for use in its own restaurants, but DPI has undertaken a series of activities to deter franchisees from commencing or expanding fresh dough production in their own restaurants in competition with DPD. For example, when the franchisees recently began a campaign to encourage fresh dough production at the Store level, DPI increased the processing fees and changed the standards and inspection practices for obtaining and maintaining DPI's approval, making fresh dough production at the Store level more cumbersome and expensive and eliminating much of the savings that

otherwise could have been achieved by franchisees making their own dough.

37. Some franchisees who operate multiple restaurants have, for several years, engaged in the production of fresh dough in approved commissaries and transported the fresh dough from the respective franchisee's commissary to that franchisee's several restaurants. IFAC has solicited bids from these franchisees and has been advised that they are able and willing to sell fresh dough to other franchisees at prices ranging from 25% to 40% below DPD's current prices. However, DPI has eliminated franchisees' commissaries as prospective suppliers to other franchisees in competition with DPD by unreasonably prohibiting them from selling fresh dough products to other franchisees.

38. DPI has exercised its control over the manufacture of fresh dough for use in Domino's Stores, and its economic power as the dominant supplier of such dough, both to foreclose competition in the sale of fresh dough itself and to foreclose the development of competition with DPD in the purchasing and distribution of other Ingredients and Supplies not manufactured by DPD.

39. In 1993, recognizing that the prices Domino's franchisees were paying DPD for Ingredients and Supplies were far in excess of those that would be available through competitive purchasing, IFAC began to explore alternative purchasing methods for Ingredients and Supplies used in Domino's Stores. It began discussions at that time with FPC, an existing franchisee cooperative purchasing organization which acts as purchasing agent for

franchisees of Kentucky Fried Chicken, Taco Bell, Dairy Queen, and Long John Silver's.

40. In the Purchasing Affiliation Agreement it entered into with FPC on June 15, 1994, IFAC appointed FPC to act as purchasing agent for its franchisee members, and authorized FPC to develop a cooperative purchasing program for all Domino's franchisees who desired to purchase Ingredients and Supplies, from sources other than DPD.

41. At least two prerequisites must be satisfied in order for FPC to effectively compete against DPD in the market for supplying Ingredients and Supplies to Domino's franchisees. First, because franchisees may prefer to purchase all, or almost all, Ingredients and Supplies from a single distributor, each distributor competing with DPD must have access to all products required in the operation of a Domino's Store. Second, distributors and suppliers need a reasonable expectation that they may have a sufficient volume of franchisee purchases to justify the investments necessary to enter the market for supplying Ingredients and Supplies to Domino's franchisees.

42. From the time DPI became aware of IFAC's discussions with FPC to the present, DPI has engaged in a continuing series of acts and practices intended to prevent FPC from successfully establishing a cooperative purchasing program in competition with DPD in the supply and distribution of Ingredients and Supplies to Domino's franchisees.

43. For several months after IFAC notified DPI of FPC's appointment, DPI refused to recognize FPC as a purchasing agent for IFAC members. Thereafter, DPI

deliberately delayed and impeded FPC's efforts to act as a competing purchasing agent for IFAC members.

44. For example, in order to obtain DPI's approval to act on behalf of IFAC and its members, FPC was required to agree not to obtain price quotations from suppliers who were not already approved by DPI, thus restricting FPC's ability to explore and promote competitive alternatives at the supplier level.

45. When IFAC and FPC asked DPI to furnish FPC with the specifications necessary to obtain quotations. from existing Domino's System suppliers, DPI delayed issuing specifications to FPC for unreasonably long periods, and ultimately delivered only vague descriptions that lacked the detail necessary to permit potential new suppliers or, for that matter, existing suppliers, to issue meaningful price quotations.

46. In late 1993, shortly after IFAC entered into negotiations with FPC, DPI began a campaign to lure its larger franchisees into exclusive dealing arrangements with DPD, thereby eliminating their purchasing volume from the potential cooperative purchasing pool. In late 1994, while continuing its efforts on other fronts to delay and impede FPC'S progress in establishing a purchasing system competitive with DPD, DPI entered into similar exclusive dealing arrangements with a broader base of franchisees.

47. These arrangements provided discounts and rebates to the contracting franchisees in exchange for their commitment to purchase all of their Ingredients and Supplies from DPD. These exclusionary arrangements were intended to foreclose competition in the market for

supplying Ingredients and Supplies to Domino's franchisees by depriving the cooperative purchasing pool of sufficient volume to make the alternative cooperative purchasing arrangements being organized by FPC feasible.

48. DPI also entered into exclusive dealing arrangements with the only supplier approved by DPI for the supply of deep-dish pizza crusts, Pillsbury Grand Metropolitan Food Service USA, thereby foreclosing the availability of this essential product to the FPC alternative purchasing program at least until May 1995, when in anticipation of the filing of this action, DPI declared Pillsbury released from the exclusivity provisions of their agreement. Likewise, DPI announced in September 1994 that it would approve a second deep-dish shell supplier, but did so only in May 1995, in anticipation of this lawsuit.

49. In a similar fashion, DPI entered into a requirements contract with an existing thin-crust shell supplier, TNT Crust, Inc. ("TNT"), for a substantial portion of the Domino's System's projected thin-crust pizza shell requirements. Thereafter, TNT delayed responding to FPC's request for competitive price quotations for several months. When it did respond, the discriminatorily high prices it quoted to FPC would not permit FPC to effectively compete with DPD. When confronted with FPC's knowledge of this fact, TNT withdrew its offer to FPC altogether, thereby leaving FPC with only the franchisees' least preferred supplier as a possible source of thin-crust shells.

50. In addition to dough products, DPI entered into contracts with approved pizza sauce suppliers for the expected requirements of the entire Domino's System, thereby effectively denying FPC access to existing approved supplies of this essential Ingredient as well. FPC presented to DPI for approval a qualified supplier that agreed to furnish FPC a sauce product meeting DPI's specifications and quality control requirements at prices lower than those offered by any other DPI-approved sauce supplier. DPI refused even to consider this qualified low-cost alternative supplier for many months, and did not grant approval until May 1995, in anticipation of the filing of this action. In sum, DPI's exclusionary arrangements constitute a group boycott of the FPC, which were intended to and did foreclose competition in the market for Ingredients and Supplies to Domino's Stores.

51. Shortly after FPC commenced its efforts to compete with DPD in the market for supplying Ingredients and Supplies to Domino's franchisees, DPD sharply reduced its prices for most products other than fresh dough, allowing DPI to announce to Domino's franchisees that its prices were competitive with those which FPC was expected to offer. At the same time, DPD raised its prices for fresh dough, the most critical Ingredient and one over which DPI has maintained nearly an absolute monopoly. DPI's profit margin on fresh dough before the price increase was already in excess of customary margins in the industry. It is now approximately five times the industry standard, amply demonstrating DPI's ability to control prices and exclude competition in this essential Ingredient for Domino's franchisees.

52. When FPC requested that DPD agree to sell fresh dough directly to distributors engaged by FPC, DPD quoted unreasonable and non-competitive selling prices that were too high to permit any distributor engaged by FPC to purchase and deliver the product to Domino's franchisees on a basis competitive with DPD.

53. DPI also refused to allow franchisees to purchase only dough from DPD, explicitly conditioning the purchase of fresh dough from DPD upon the franchisees' agreement to purchase other Ingredients and Supplies from DPD. It announced a relaxation of this policy only in May 1995, in anticipation of the filing of this action.

54. DPI also refused to approve certain distributors proposed by FPC except upon unreasonable conditions, imposing on prospective competing distributors unreasonable requirements that are not customary in the industry and are far more restrictive than necessary for quality control to protect DPI's legitimate interests in its trademarks and service marks.

55. IFAC sponsored a trade show in Orlando, Florida in August 1994 to present the proposed FPC cooperative purchasing program to Domino's franchisees and suppliers of Ingredients and Supplies. Upon information and belief, DPI contacted several of the most important suppliers and urged them not to participate in the IFAC trade show. As a result, many important suppliers did not participate, did not discuss alternative supply arrangements with FPC, and did not purchase display space from IFAC.

56. DPI has further acted to impede the development and implementation of an alternative purchasing

program by selectively enforcing various provisions of the Standard Franchise Agreement in an unreasonable and discriminatory manner against those franchisees who are providing leadership to the alternative purchasing effort. The Standard Franchise Agreement prohibits involvement by franchisees in business activities unrelated to the operation of their Domino's Stores, and imposes other restrictions on their business and personal activities. DPI has selectively invoked and enforced these provisions in a discriminatory and unreasonable manner against members of the IFAC Board of Directors, among others.

57. DPI has also acted to impede the development and implementation of an alternative purchasing program by conditioning certain cooperative advertising commitments and franchisee debt financing arrangements on franchisee purchase of Ingredients and Supplies from DPD.

58. Prospective Domino's franchisees, at the time they were considering entry into the Standard Franchise Agreement with DPI, were not advised that DPI would enforce a policy or practice of preventing competition with DPD for the supply of Ingredients and Supplies to franchisees. On the contrary, prospective franchisees were led to believe, based at least upon the Uniform Franchise Offering Circular used by DPI to solicit new franchisees, that DPD was only one approved supplier of Ingredients and Supplies; that alternative approved suppliers would be available to the franchisees for competitive purchasing opportunities; and that DPI would act reasonably in approving competing suppliers in the

future. Section VIII of the Offering Circular, on page 25, states as follows:

> Except as noted below, DPI does not presently require that a franchisee, area franchisee or developer purchase or lease from DPI or its designee goods, services, supplies, fixtures, equipment, inventory or real estate as a condition of establishing or operating the franchise business. However, DPI has the right to impose certain requirements and/or restrictions on the manner in which various items are supplied to or purchased by franchisees. These are described in Item IX below.

Item IX(B)(2) sets out, essentially verbatim, the language of Section 12.2 of the Standard Franchise Agreement, in which DPI merely reserves the right to require that ingredients, supplies and materials be purchased exclusively from DPI or from approved suppliers or distributors.

59. Immediately following the Section 12.2 language, the offering Circular states that Domino's Pizza Distribution Corp. (now the DPD division of DPI) is "*an* approved supplier of food and beverage products, supplies and materials" (emphasis added). From this language, as well as the global assurance that DPI will act "reasonably" with respect to franchisees as described in paragraph ¶21, *supra*, prospective franchisees were justified in believing that DPD would be just one supplier or distributor of such products, not the only supplier or distributor, as DPI's anticompetitive conduct has made the reality.

60. Moreover, because DPI conditions the acquisition of a Domino's franchise on substantial prior employment within the Domino's System, and because DPI encourages and actively promotes Domino's Store managers to acquire Domino's franchises as the way to further their careers within the Domino's System, prospective Domino's franchisees (the majority of whom are quite young and inexperienced in business and financial matters) do not "comparison shop" the benefits and costs of a Domino's franchise with those of other pizza or fast food franchises. Prospective Domino's franchisees therefore do not even consider alternative pizza or fast food franchise acquisitions when they make their decision to acquire a Domino's franchise.

61. Domino's franchisees who sign the Standard Franchise Agreement cannot switch their investment in their Domino's franchise enterprises to an alternative franchise or business opportunity without violating the Standard Franchise Agreement unless they are able to sell their Domino's franchise, which in itself requires DPI's approval and may inflict substantial costs and loss of investment. DPI's unreasonably restrictive approval policies have made the sale of a Domino's franchise difficult, and likely to result in a significant financial loss for the selling franchisee. Thus Domino's franchisees are effectively locked in to the non-competitive purchasing and supply system controlled by DPI.

62. Ingredients and Supplies used in the operation of Domino's franchises are products and services separate and distinct from the right acquired by franchisees under the Standard Franchise Agreement to conduct business using the Domino's System business format and

associated trademarks, service marks, commercial symbols and business methods. Individual Ingredients and Supplies, such as fresh dough and sauce, are also (a) separate and distinct from each other, and (b) separate and distinct from Distribution Services.

63. Moreover, all other ingredients, supplies and materials used in the operation of Domino's pizza franchises comprise a product market separate and distinct from other pizza and fast food franchises. By reason of DPI's rights to approve Domino's Ingredients and Supplies and its restrictive and manipulative exercise of that power, Domino's franchisees, including the Franchisee Plaintiffs, are unable to utilize all of the other food, packaging, equipment, and distribution services suitable for use by a retail pizza or other fast food outlet, and they are instead limited solely to Domino's Ingredients and Supplies.

64. As such, Domino's Ingredients and Supplies are not reasonably substitutable with or equivalent to any other food, packaging, equipment and distribution services suitable for use by a retail pizza or other fast food outlet, and there is no effective cross-elasticity of demand between Domino's Ingredients and Supplies, and the market for all other food, packaging, equipment, and distribution services. That is, demand for Domino's Ingredients and Supplies, Materials, and Distribution Services does not change in response to changes in the price for other food packaging equipment and distribution services suitable for use by a retail pizza or other fast food outlet.

65. Moreover, at least because of the information and switching costs referred to at least in ¶¶58-61, *supra*, there is no effective cross-elasticity of demand between the market for Domino's Pizza franchises and the market for any other pizza or fast food franchises. That is, demand for a Domino's franchise does not respond to changes in the price for other franchises.

66. Finally, at least because of the information and switching costs described at least in ¶¶58-61, *supra*, there is no effective cross-elasticity of demand between the market for Domino's franchises and the market for Domino's Ingredients and Supplies. That is, Domino's franchisees, including the Franchisee Plaintiffs, are unable to acquire alternative pizza or other fast food franchises in response to an increase in the price of Domino's Ingredients and Supplies and the demand for a Domino's franchise does not respond to changes in the price for Domino's Ingredients and Supplies.

67. By reason of its control over the availability of Ingredients and Supplies for use in the operation of Domino's Stores and its power to discipline franchisees and control their franchises, DPI has sufficient economic power to substantially restrain competition at least in the market for Ingredients and Supplies for use in the operation of Domino's Stores.

68. As a direct and proximate result of DPI's acts and omissions complained of in this Second Amended Complaint, competition has been lessened and foreclosed in the market for supplying Ingredients and Supplies to Domino's franchisees. Rival suppliers of Ingredients and Supplies have been foreclosed from access to purchasers

in the market for such supplies by the acts of DPI complained of herein.

69. As a direct and proximate result of the foreclosure of such competition, the Franchisee Plaintiffs, and nonparty Domino's franchisees, have been charged supracompetitive prices for dough and for other Ingredients and Supplies, thereby diminishing the Franchisee Plaintiffs' profits. The Franchisee Plaintiffs' lost profits result directly from DPI's acts in foreclosing competition in the market and are therefore injuries of the type the antitrust laws were intended to prevent.

70. The foreclosure of rival suppliers from the market for supplying Ingredients and Supplies to Domino's franchisees, and the supracompetitive, monopolistic prices charged by DPI to its customers in the market for Ingredients and Supplies, have harmed, or if not restrained or otherwise remedied by this Court inevitably will harm, the purchasers of finished pizza at the retail level at least because:

a. Franchisees have passed or will pass on some or all of the supracompetitive prices to such purchasers, or

b. Franchisees have absorbed or will absorb those supracompetitive prices and compensate for that absorption by providing lower quality or service to retail purchasers.

71. As a result of DPI's activities foreclosing competition with DPD alleged in this Second Amended Complaint, the Franchisee Plaintiffs and all other Domino's franchisees have paid and are continuing to pay higher than competitive prices for the Ingredients and Supplies

required for use in their franchise businesses. The amount of these overcharges is at present undetermined, but is estimated to be between $3,000 and $10,000 per Store annually.

Claims for Relief

COUNT I: Violation Of The Sherman Act (15 U.S.C. §2)

72. Plaintiffs incorporate by reference and restate the allegations contained in paragraphs 1-71, *supra*.

73. At least by reason of its control over the availability of Ingredients and Supplies for use in the operation of Domino's Stores and its power to discipline franchisees and control their franchises, DPI has the power to control prices and exclude competition in the market for Ingredients and Supplies to Domino's Stores.

74. DPI has willfully acquired and maintained, and has attempted and conspired with others to acquire and maintain, a monopoly in the market for Ingredients and Supplies used in the operation of Domino's Stores.

75. DPI's monopolization, attempts to monopolize, and conspiracy with others to monopolize these markets constitute acts in violation of Section 2 of the Sherman Act, 15 U.S.C. §2.

76. By reason of DPI's acts in violation of the Sherman Act, the Franchisee Plaintiffs have been injured in their business or property and are entitled to recover treble damages and their costs of this action, including their reasonable attorneys' fees.

COUNT II: Violation Of The Sherman Act And The Clayton Act (15 U.S.C. §§1, 14)

77. Plaintiffs incorporate by reference and restate the allegations of paragraphs 1-76, *supra*.

78. DPI has exercised its economic power to exclude competition with DPD at least in the sale of Ingredients and Supplies to Domino's franchisees, including the Franchisee Plaintiffs, and has unreasonably forced the franchisees to forego free choice among competing suppliers of such products and services. These unlawful activities have forced unwilling purchases of products and services provided by DPD, including at least the unwanted tying of Ingredients and Supplies to sales of dough, and the tying of Ingredients and Supplies to continued enjoyment of rights and services under the Standard Franchise Agreement. Both of these unlawful tying arrangements were imposed upon Domino's franchisees, including the Franchisee Plainitffs [sic], after they executed the Standard Franchise Agreement. These actions have increased prices paid by Domino's franchisees, including the Franchisee Plaintiffs, for Ingredients and Supplies to supracompetitive levels.

79. The exclusive dealing arrangements alleged in this Amended Complaint were entered into by DPI for the purpose and with the effect of foreclosing competition with DPD in the sale of Ingredients and Supplies for use in the operation of Domino's Stores, and constitute a group boycott of IFAC and FPC.

80. The actions of DPI alleged in this Second Amended Complaint have affected and continue to affect

a substantial amount of interstate commerce in Ingredients and Supplies. These anticompetitive effects are intended to and do occur throughout the geographic market of the United States of America, which DPI and DPD manipulate through the use of Regional Distribution Centers.

81. The actions of DPI alleged in this Second Amended Complaint constitute unreasonable restraints of trade, including unlawful tying arrangements and group boycotts, in violation of Section 1 of the Sherman Act, 15 U.S.C. §1, and Section 3 of the Clayton Act, 15 U.S.C. §14.

82. By reason of DPI's acts in violation of the Sherman Act and the Clayton Act, the Franchisee Plaintiffs have been injured in their business or property and are entitled to recover treble damages and their costs of this action, including their reasonable attorneys' fees.

Count III: Injunctive Relief (15 U.S.C. §26)

83. Plaintiffs incorporate by reference and restate the allegations contained in paragraphs 1-82, *supra.*

84. DPI's acts in violation of the Sherman Act and the Clayton Act are continuing or threaten to continue, and will continue to injure all of the plaintiffs unless DPI is enjoined from continuing the anticompetitive practices described in this Second Amended Complaint. Plaintiffs therefore are entitled to permanent injunctive relief pursuant to Section 16 of the Clayton Act, 15 U.S.C. §26.

Count IV: Breach Of Contract

85. Plaintiffs incorporate by reference and restate the allegations contained in paragraphs 1-84, *supra*.

86. The Standard Franchise Agreement expressly obligates DPI to "exercise reasonable judgment with respect to all determinations to be made" by DPI under the terms of the Agreement. In its determinations made under the Standard Franchise Agreement as alleged in this Amended Complaint, DPI has failed and refused to exercise reasonable judgment and has therefore breached its obligations under the Standard Franchise Agreement.

87. As a result of DPI's breach of the Standard Franchise Agreement, the Franchisee Plaintiffs have been injured in their business and property and have sustained damages at least as alleged in ¶71 of this Second Amended Complaint.

Count V: Breach Of The Implied Covenant Of Good Faith And Fair Dealing

88. Plaintiffs incorporate by reference and restate the allegations contained in paragraphs 1-87, *supra*.

89. By its actions as described in this Amended Complaint, DPI has breached the covenant of good faith and fair dealing in the performance and enforcement of the contract implied by law in every contract, including the Standard Franchise Agreement.

90. As a result of DPI's breach of its obligation of good faith and fair dealing, the Franchisee Plaintiffs have been injured in their business and property and have

sustained damages at least as alleged in ¶71 of this Second Amended Complaint.

Count VI: Tortious Interference With Economic Relations

91. Plaintiffs incorporate by reference and restate the allegations contained in paragraphs 1-90, *supra.*

92. IFAC and FPC entered into a formal Purchasing Affiliation Agreement on June 15, 1994 to develop and implement a program for competitive purchasing of Ingredients and Supplies on behalf of Domino's franchisees.

93. IFAC has expended substantial sums of money as part of its effort to develop and implement a competitive purchasing program and as part of its effort to secure DPI approval of a competitive purchasing program. IFAC's expenditure of these sums has been made futile as a result of DPI's conduct, as alleged in this Second Amended Complaint.

94. Through the conduct alleged in this Second Amended Complaint, DPI intentionally and improperly interfered with and continues to interfere with the performance and fulfillment of the Purchasing Affiliation Agreement.

95. As a result of DPI's tortious interference with performance and fulfillment of the Purchasing Affiliation Agreement, IFAC has been injured and has sustained damages in amounts to be proved at trial. IFAC will continue to be injured unless DPI's conduct is enjoined.

COUNT VII: Declaratory Judgment (28 U.S.C. §2201)

96. Plaintiffs incorporate by reference and restate the allegations contained in paragraphs 1-95, *supra*.

97. The dispute between DPI and the plaintiffs constitutes a real controversy which is ripe for judicial resolution.

98. Plaintiffs are entitled to a declaration that the acts of DPI as alleged in this Second Amended Complaint constitute:

* violations of Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act, 15 U.S.C. §§1, 2 and 14;
* breaches of the Standard Franchise Agreement;
* breach of the implied covenant of good faith and fair dealing contained in the Standard Franchise Agreement; and
* tortious interference with the actual and prospective fulfillment of the Purchasing Affiliation Agreement.

Prayer for Relief and Jury Demand

Wherefore, Plaintiffs respectfully demand:

(a) That process issue requiring Defendant DPI to appear in this Court and answer the allegations of the Amended Complaint;

(b) That the Franchisee Plaintiffs be awarded three times the damages they have sustained by reason of DPI's violation of Sections 1 and 2 of the Sherman Act and

Section 3 of the Clayton Act, together with their costs and reasonable attorneys' fees pursuant to Section 4 of the Clayton Act, 15 U.S.C. §15;

(c) That the Franchisee Plaintiffs be awarded the actual damages they have sustained by reason of DPI's breach of the express obligations of the Standard Franchise Agreement and the obligation of good faith and fair dealing implied by law in the Standard Franchise Agreement;

(d) That IFAC be awarded the actual damages it has sustained by reason of DPI's tortious interference with performance and fulfillment of the Purchasing Affiliation Agreement between IFAC and FPC;

(e) That defendant DPI be permanently enjoined from further violations of the antitrust laws, breaches of the Standard Franchise Agreement, breaches of the implied covenant of good faith and fair dealing, and tortious interference with performance and fulfillment of the Purchasing Affiliation Agreement;

(f) That this Court declare that the actions of DPI alleged in this Amended Complaint violate Sections 1 and 2 of the Sherman Act, violate Section 3 of the Clayton Act, constitute violations of the Standard Franchise Agreement and DPI's covenant of good faith and fair dealing, and constitute tortious interference with the Purchasing Affiliation Agreement;

(g) That Plaintiffs have trial by Jury of all issues raised by this Amended Complaint; and

(h) For such other and further relief as may be necessary and proper in the circumstances of this case.

Respectfully submitted,

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EXHIBIT A

Store # _____

DOMINO'S PIZZA, INC.
STANDARD FRANCHISE AGREEMENT

_____
Franchisee

TABLE OF CONTENTS

		Page
1.	INTRODUCTION	1
2.	GRANT AND TERM OF FRANCHISE	1
	2.1 Grant	1
	2.2 Term of Franchise	1
3.	RENEWAL OF FRANCHISE	2
	3.1 Option to Renew	2
	3.2 Manner of Renewal	2
	3.3 Notification of Expiration	2
4.	TERRITORIAL RIGHTS AND OBLIGATIONS	2
	4.1 Area of Primary Responsibility	2
	4.2 Delivery Service	3
5.	INITIAL PAYMENTS	3
	5.1 Franchise Application Processing Fee	3
	5.2 Opening Advertising and Promotion Fee	3
	5.3 Non-Refundability of Fees	3
	5.4 Deferral of Fees	3

6. ROYALTY FEE AND OTHER CHARGES 3

6.1 Amount and Payment 3

6.2 Definition of Royalty Sales 3

6.3 Interest on Late Payments 3

6.4 Electronic Funds Transfer 4

6.5 Application of Payments 4

7. STORE LOCATION 4

7.1 Location and Use 4

7.2 Relocation 4

7.3 Location and Operation of Commissary 4

7.4 Store Lease 4

7.5 Assumption of Lease on Termination or Expiration 5

8. STORE DEVELOPMENT 5

8.1 Initial Development and Construction 5

8.2 Equipment, Fixtures, Furniture and Signs 5

8.3 Store Opening 5

9. STORE REFURBISHING 6

10. TRAINING 6

10.1 Initial Training 6

10.2 Training of Employees 6

10.3 Additional Training 6

11. OPERATING ASSISTANCE 7
11.1 Advice and Guidance 7
11.2 Operating Problems 7
12. STORE PRODUCTS 7
12.1 Store Menu 7
12.2 Pizza Ingredients, Supplies and Materials 7
13. ADVERTISING AND PROMOTION 8
13.1 By DPI 8
13.2 Local and Regional Advertising Cooperatives 8
13.3 By Franchisee 9
14. RECORDS AND REPORTS 9
14.1 Bookkeeping and Recordkeeping 9
14.2 Sales Reports and Financial Statements .. 9
14.3 Right to Require Audit 10
15. OPERATING REQUIREMENTS 10
15.1 Operating Procedures 10
15.2 Compliance with Laws and Other Business Practices 11
15.3 Prices To Be Determined By Franchisee .. 11
15.4 Operating Manual 11
15.5 New Concepts 11
15.6 Franchisee Must Directly Supervise Store .. 12
15.7 Insurance 12
15.8 Identification as Franchisee 13
16. MARKS 13
16.1 Usage 13
16.2 Infringements 13

16.3 Indemnification 14

17. INSPECTIONS 14

18. TERMINATION AND EXPIRATION 14

18.1 Termination By Franchisee 14

18.2 By DPI 14

18.3 Obligation Upon Termination or Expiration 16

19. OPTION TO PURCHASE STORE 16

19.1 Option 16

19.2 Formula Price 16

19.3 Purchase of Commissary 17

19.4 Deductions From Purchase Price 17

19.5 Payment of Purchase Price 17

19.6 Real Property 18

19.7 Closing 18

19.8 Operation During Option Period 18

19.9 Formula Price 18

20. RESTRICTIVE COVENANTS 19

20.1 In-Term Covenant 19

20.2 Post-Term Covenant 19

20.3 Ownership of Public Companies 19

20.4 Solicitation of Employees 19

20.5 Customer Lists and Trade Secrets; New Processes, Concepts, Improvements, Etc 19

20.6 Owners of Corporation or Partnership ... 20

21. ASSIGNMENT 20
21.1 By DPI 20
21.2 By Franchisee 20
21.3 Assignment to Corporation of Partnership 20
21.4 Assignment or Transfer to Others 21
21.5 Death or Permanent Disability 21
21.6 Definition of Permanent Disability 22
21.7 Operation by DPI After Death or Permanent Disability 22
21.8 Right of First Refusal of DPE 22
22. CONTRACT INTERPRETATION AND ENFORCEMENT 23
22.1 Effect of Waivers 23
22.2 Cost of Enforcement 23
22.3 Indemnification of DPI 23
22.4 Construction and Severability 23
22.5 Scope and Modification of Agreement 24
22.6 Governing Laws 24
22.7 Notices 24
22.8 Independent Contractors 24
22.9 Standard of Reasonableness 24
22.10 Acknowledgment 24
22.11 Binding Effect 24
22.12 Effective Date of this Agreement 25

DOMINO'S PIZZA, INC.

STANDARD FRANCHISE AGREEMENT

This Franchise Agreement (this "Agreement") is being entered into between Domino's Pizza, Inc., a Michigan corporation ("we", "DPI" or "us" in this Agreement), and _____

("You" or "Franchisee" in this Agreement). If you are a corporation or partnership or if this Agreement is transferred to a corporation or partnership, the term "owners" in this Agreement refers to the shareholders or partners of such corporation or partnership. Unless otherwise approved by DPI, the term "controlling shareholder or partner" refers to the person who owns fifty-one percent (51%) or more of the general partnership interest of such partnership or the equity and voting power of the issued and outstanding capital stock of such corporation.

1. INTRODUCTION.

DPI has developed and operates retail outlets specializing in the sale of pizza and featuring carry-out and delivery services. These outlets are known as "Domino's Pizza" stores and conduct business under a uniform business format, specially designed equipment and specifications for the preparation and sale of pizza and other authorized food products (the "Domino's System"). DPI also owns, uses, promotes and licenses certain valuable trademarks, service marks and commercial symbols in connection with the operation of Domino's Pizza Stores including the mark "Domino's Pizza" (the "Marks").

You have applied to DPI for a franchise to operate a Domino's Pizza Store utilizing the Domino's System and the Marks at the location identified in this Agreement. Your application has been approved by DPI in reliance upon all of the representations made in your application including those concerning your financial resources, your other investments and interests and the manner in which the franchise will be owned and operated.

You acknowledge that you have read this Agreement and our Uniform Franchise Offering Circular and been given an opportunity to obtain clarification of any provision that you did not understand. You also understand and agree that the terms and conditions contained in this Agreement are necessary to maintain DPI's high standards of quality and service and the uniformity of those standards at all Domino's Pizza Stores.

2. GRANT AND TERM OF FRANCHISE.

2.1 ***Grant.*** Subject to the terms of this Agreement, DPI grants to you a franchise to operate a Domino's Pizza Store (the "Store") under the Domino's System and a license to use the Marks in the operation of the Store at the following location: _____

_____

_____.

2.2 ***Terms of Franchise.*** The term of this Agreement shall be for a period of ten (10) years, commencing on the date of opening of the Store (or if this Agreement is being signed in connection with a renewal or transfer of the

franchise, commencing on the day following the expiration or termination of the previous franchise agreement, as the case may be).

3. RENEWAL OF FRANCHISE.

3.1. ***Option to Renew.*** You may, at your option, renew the franchise for one additional ten (10) year term at the end of the initial term, provided:

(a) you are not in default of any provision of this Agreement or any other agreement with us or our subsidiaries or affiliates or any other creditor or supplier of the Store and have substantially complied with the terms and conditions of these agreements during their terms;

(b) you are able to maintain possession of the Store premises or to secure and develop a suitable alternative site approved by us; and

(c) you refurbish the size as provided in Paragraph 9 of this Agreement.

3.2. ***Manner of Renewal.*** In connection with a renewal of this Agreement, you must execute our then current form of standard franchise agreement and all other agreements customarily used by us in the renewal of franchises. You understand that the renewal franchise agreement may provide for higher royalty fees and greater expenditures for advertising and promotion than are provided for in this Agreement and may contain other terms materially different form the terms of this Agreement. The area of primary responsibility of the Store will not be modified unless such modification is consistent with criteria than in effect for comparable market areas.

There will be no initial franchise or similar fee charged upon a renewal of the franchise. You will also be entitled to renew the franchise at the end of the renewal term in accordance with the renewal provisions, if any, contained in the franchise agreement executed by you in connection with your renewal of the franchise.

3.3 ***Notification of Expiration.*** We will send all agreements relating to renewal of the franchise for your review and execution approximately six (6) months prior to the expiration of this Agreement along with a notification of the expiration of this Agreement. Your failure to return these agreements to use within thirty (30) days of receipt will be deemed an election by you not to renew this Agreement. Our notice will also state what actions, if any, you must take to correct the deficiencies in your operation of the Store and will specify the time period in which these deficiencies must be corrected. Renewal of the franchise will be conditioned on your continued compliance with all the terms and conditions of this Agreement and all other agreements with us and our affiliates and subsidiaries and all other creditors and suppliers of the Store up to the date of expiration.

4. TERRITORIAL RIGHTS AND OBLIGATIONS.

4.1 ***Area of Primary Responsibility.*** The following geographic territory will be your Area of Primary Responsibility:

_____

_____.

Provided you are in compliance with the terms of this Agreement, we will not operate or grant a franchise for the operation of a Domino's Pizza Store during the term of this Agreement whose area of primary responsibility overlaps your Area of Primary Responsibility.

4.2 ***Delivery Service.*** We shall have the right to prescribe from time to time the boundaries beyond which the Store may not offer delivery service. You further understand that in revising these boundaries we may in our discretion make adjustments to the size of your delivery and service area to account for, among other things, changing market conditions, population changes and other relevant considerations. You further agree that the Store will at all times during approved hours of operation offer delivery service to all customers located within your delivery and service area, consistent with the rules and procedures established by us from time to time; provided, however, we will not require you to offer delivery service in areas which, in our judgment, might present a danger to you or your employees. When making deliveries, you and your employees must strictly comply with all laws, regulations and rules of the road and due care and caution in the operation of delivery vehicles.

5. INITIAL PAYMENTS.

5.1 ***Franchise Application Processing Fee.*** Upon signing of this Agreement, you agree to pay us an initial franchise application processing fee (or, if this Agreement is being signed in connection with a transfer of the franchise, a transfer fee) in the amount of _____.

5.2 ***Opening Advertising and Promotion Fees.*** You agree to pay us or as we designate or approve an opening advertising and promotion fee in the amount of _____.

5.3. ***Non-Refundability of Fees.*** The fees payable under this Paragraph 5 are not refundable under any circumstances.

5.4 ***Deferral of Fees.*** If you are a franchisee in the State of Maryland, Minnesota, South Dakota or Washington, the payment of all fees described in this Section 5 shall be deferred until the date on which you commence operation of the Store.

6. ROYALTY FEE AND OTHER CHARGES.

6.1 ***Amount and Payment.*** During the term of the franchise, you agree to pay us a royalty fee of five and one-half percent (5½%) of the weekly royalty sales of the Store. This fee must be postmarked on Monday and paid by Wednesday of each week on royalty sales for the week ending on the preceding Sunday.

6.2 ***Definition of Royalty Sales.*** The term "royalty sales" means the total receipts from all sales by the Store of all pizza, beverages and other products or services authorized for sale at the Store but exclusive of sales and equivalent taxes and coupon and similar discounts or beverage container deposits approved by us. Premium items or similar items must be included in computing royalty sales unless these items have been sold at or below cost by the Store.

6.3 ***Interest on Late Payments.*** All royalty fees, advertising contributions and all other amounts owed to

us pursuant to this Agreement will bear interest after the due date at the rate of one and one-half percent (1½%) per month or at the highest legal rate for open account business credit in the state in which the Store is located, whichever is lower.

6.4 ***Electronic Funds Transfer.*** In addition, if you fail to pay when due royalty fees, advertising contributions or any other amounts owed to us pursuant to this Agreement, we have the right to require you to participate in the electronic funds transfer program under which we automatically deduct payments for royalty fees and advertising contributions from your bank account.

6.5 ***Application of Payments.*** When we receive a payment for you, we have the right in our sole discretion to apply it as we see fit to any past due indebtedness of yours due to us or our affiliates, whether for royalties, advertising contributions, purchases, interest, or for any other reason, regardless of how you may designate a particular payment to be applied.

7. STORE LOCATION.

7.1 ***Location and Use.*** You may operate the Store at the location specified in Paragraph 2.1 and you may not relocate the Store except with our prior written consent. The Store may only be used for the operation of a Domino's Pizza Store and other related activities approved by us in writing. You shall not allow the premises of the Store to be used for any immoral or illegal purpose.

7.2 ***Relocation.*** If your lease expires or terminates without your fault or if the site is condemned, destroyed

or rendered unusable, we will grant permission for relocation of the Store to a location and site meeting our standards. Any relocation will be at your sole expense.

7.3 ***Location and Operation of Commissary.*** Any commissary operated by you in connection with the Store may be located only at the premises of the Store or other premises approved by us in writing and must be operated in accordance with commissary standards prescribed by us from time to time. Such commissary must be owned by you and operated by you and your employees exclusively for the benefit of the Store or other Domino's Pizza Stores owned by you and may not be owned or operated by any other person or entity without our prior written consent. You may not open or operate a commissary unless you have received prior written notification from us that you have satisfied in advance all of our requirements for the operation of a commissary, including all required training of commissary personnel.

7.4 ***Store Lease.*** The lease for the site of the Store (including the lease for the site of the commissary, if any, to be operated by you in connection with the Store:

(a) shall contain no provision which bases the amount of the rent due upon the volume of sales;

(b) shall provide for adequate parking and permit standard signage; and

(c) shall contain provisions in the form approved by us which allows for assignment of the lease to us or our designee and which requires the lessor to give us notice of any

defaults by you under the lease and an opportunity to cure any such default in the event you fail to do so.

The lease must be submitted to us prior to execution for our examination and approval that it contains the terms we require in all leases.

7.5 ***Assumption of Lease on Termination or Expiration.*** Upon the termination or expiration of the franchise for any reason, other than a termination by you for cause, we shall have the right to assume your status and replace you as lessee. Upon exercise of that right by us, you will be fully released and discharged from all liability for rent and all other future liability under the lease (although not from any liability for unpaid rent or any other then existing liability to the lessor under the lease). If we exercise our right to assume your lease, we will indemnify you and hold you harmless against any claim made for future rent or other future liability under the lease.

8. STORE DEVELOPMENT.

8.1 ***Initial Development and Construction.*** You agree that promptly after obtaining possession of the site for Store you will:

(a) cause to be prepared and submit for approval by us a site plan and any modifications to our basic architectural plans and specifications for the Store, including requirements for dimensions, exterior design, materials, interior layout, equipment, fixtures, furniture, signs, and decorating. You understand that you may modify our basic plans and specifications only to the

extent required to comply with applicable ordinances, building codes and permit requirements and only with our prior written approval;

(b) obtain all required zoning changes; all required building, driveway, utility, health, sanitation, and sign permits and any other required permits;

(c) purchase or lease equipment, fixtures, furniture and signs meeting our specifications and requirements;

(d) complete the construction and/or remodeling, equipment, fixture, furniture and sign installation and decorating of the Store in full and strict compliance with plans and specifications approved by us and all applicable ordinances, building codes and permit requirements; and

(e) obtain all customary contractors' sworn statements and partial and final waivers of lien for construction, remodeling, decorating and installation services.

8.2 ***Equipment, Fixtures, Furniture and Signs.*** We will provide you with specifications for pizza and beverage preparation, dispensing, storage and display equipment, delivery and related motor vehicles, other equipment, fixtures, furniture, exterior and interior signs and decorating required for the Store. You may purchase items meeting our specifications from any source. If you propose to purchase or lease items not previously approved by us as meeting our specifications, you must first notify us and we may require submission of sufficient specification, photographs, drawings and/or other information and samples to determine whether any such

items meet our specifications. We will advise you within a reasonable time whether any proposed item meets our specifications. We reserve the right to charge you for our reasonable expenses in testing and/or evaluating any proposed item submitted by you.

8.3 ***Store Opening.*** You agree to complete development of the Store and have the Store ready to open within a reasonable time after obtaining possession of the site for the Store. If you do not open the Store within six (6) months from the effective date of this Agreement, we will have the option to terminate this Agreement upon the giving of written notice to you.

9. STORE REFURBISHING.

You agree to refurbish the Store (in addition to regular maintenance and repair), within six (6) months of receipt of written notice from us, as we may from time to time require to maintain or improve the appearance and efficient operation of the Store, to increase its sales potential or to comply with our standards and identity. Refurbishing may include:

(a) replacement of worn out or obsolete equipment, fixtures, furniture and signs;

(b) the substitution or addition of new or improved equipment, including computer hardware and software, and safes, fixtures, furniture and signs;

(c) redecoration;

(d) repair of the interior and exterior of the premises and repair and resurfacing of parking facilities; and

(e) structural modifications and remodeling of the premises.

You will not be required to make aggregate expenditures for refurbishing of the Store in excess of one and one-half percent (1½%) of the royalty sales of the Store from the date of its opening to the date of any required refurbishing or, except in connection with a renewal of the franchise, to effect any refurbishing of the Store during the last twelve (12) months of the initial term of the franchise.

10. TRAINING.

10.1 ***Initial Training.*** You (or the controlling shareholder or partner if you are a corporation or partnership) must enroll and complete all training programs and classes which we require for the operation of a Domino's Pizza Store. These training programs and classes will be furnished at such times and places as we designate. We have the right to charge a reasonable training fee for these training programs or classes. All training programs and classes must be completed to our satisfaction. You will be responsible for the travel, living expenses and any other costs incurred during these training programs and classes.

10.2 ***Training of Employees.*** You agree to implement a training program for employees of the Store and be responsible for their proper training. You agree not to employ any person who fails or refuses to complete your training programs or is unqualified to perform his or her duties at the Store in accordance with the requirements established for the operation of a Domino's Pizza Store.

10.3 ***Additional Training.*** We may also, at our option, require you (or the controlling shareholder or partner if you are a corporation or partnership) to attend supplemental or additional training programs which may be offered from time to time by us during the term of the franchise. You will be responsible for the reasonable costs of such programs and for the travel and living expenses and any other costs incurred during these programs.

11. OPERATING ASSISTANCE.

11.1 ***Advice and Guidance.*** We will furnish you with such reasonable operating assistance as we determine from time to time to be necessary for the operation of the Store. Operating assistance will include advice and guidance regarding:

(a) methods of pizza preparation, packaging and sale; and

(b) the establishment of administrative, bookkeeping, accounting, inventory control and general operating procedures.

You understand that the assistance provided to you under this Paragraph 11 does not obligate us to operate the Store on your behalf at any time during the term of the franchise or to provide the accounting, bookkeeping or marketing services required for the operation of the Store.

11.2 ***Operating Problems.*** We will advise you from time to time of operating problems of the Store disclosed by reports submitted to or inspections made by us. We will make no separate charge for operating or marketing assistance except that we may make reasonable charges

for forms and other materials supplied to you and for operating assistance made necessary in our judgment as a result of your failure to comply with any provision of this Agreement or for operating assistance requested by you in excess of that normally provided by us.

12. STORE PRODUCTS.

12.1 ***Store Menu.*** You agree that you will offer for sale and sell at the Store for final consumption and not for resale, all pizza and beverage products and the carry-out and delivery services that we from time to time authorize. You also agree that you will not offer for sale or sell at the Store any other products or services.

12.2 ***Pizza Ingredients, Supplies and Materials.*** all pizza ingredients, beverage products, cooking materials, containers, packaging materials, other paper and plastic products, utensils, uniforms, menus, forms, cleaning and sanitation materials and other supplies and materials used in the operation of the Store must conform to the specifications and quality standards established by us from time to time. You must use in the operation of the Store boxes, containers and other paper or plastic products imprinted with the Marks as prescribed from time to time by us. We may in our sole discretion require that ingredients, supplies and materials used in the preparation, packaging, and delivery of pizza be purchased exclusively from us or from approved suppliers or distributors. Any ingredient, supply or material not previously approved by us as conforming to our specifications and quality standards must be submitted for examination and/or testing prior to use. We reserve the right from

time to time to examine the facilities of any approved supplier or distributor, including the commissary, if any, operated by you, and to conduct reasonable testing and inspection of the ingredients, materials or supplies to determine whether they meet our standards and specifications. We also reserve the right to charge fees for testing and evaluating proposed suppliers or distributors and examining and inspecting commissary operations and to impose reasonable limitations on the number of approved suppliers or distributors of any product. Approval of a supplier or distributor may be conditioned on requirements relating to frequency of delivery, standards of service including prompt attention to complaints and the ability to service and supply Stores within areas designated by us.

13. ADVERTISING AND PROMOTION.

13.1 ***By DPI.*** We will from time to time formulate, develop, produce and conduct advertising and promotional programs in the form and media as we determine to be most effective. You agree to participate in all local, national or regional advertising and promotions as we determine to be appropriate for the benefit of Domino's System. We reserve the right in our sole discretion, to determine the composition of all geographic territories and market areas for the development and implementation of advertising and promotion programs. All costs of the formulation, development and production of any such advertising and promotion (including without limitation the proportionate compensation of our employees who devote time and render services in the formulation, development and production of such advertising and

promotion programs or the administration of the funds), will be paid from a separate fund administered by us (the "Advertising Fund"). You will be obligated to pay three percent (3%) of the weekly royalty sales of the Store to the Advertising Fund. Your contribution to the Advertising Fund must be postmarked on Monday and paid on Wednesday of each week on royalty sales for the week ending on the preceding Sunday. You agree that we shall have the right from time to time to increase your contribution to the Advertising Fund by an amount not to exceed in the aggregate one percent (1%) of the royalty sales of the Store. All Domino's Pizza Stores owned by us will contribute to the cost of such advertising and promotion programs on at least the same basis as you. We will submit to you upon request an annual accounting of the receipts and disbursements of the Advertising Fund. We reserve the right to engage the services of an advertising source or sources to formulate, develop, produce and conduct the advertising and promotion programs, the cost of such services to be payable from the Advertising Fund.

You acknowledge and understand that the Advertising Fund is intended to maximize general public recognition and patronage of the Marks in the manner determined to be most effective by us and that we undertake no obligation in developing, implementing or administering these programs to ensure that expenditures which are proportionate or equivalent to your contributions are made for the market area of the Store or that any Store will benefit directly or pro rata from the placement of advertising.

13.2 ***Local and Regional Advertising Cooperative.*** We reserve the right to require that you participate in local and regional advertising cooperatives in connection with the advertising and promotional programs administered by us or by other franchises of the System or in the event no such cooperative has been established, to require you to conduct local advertising for your Store. In addition to the advertising contribution payable by you under Paragraph 13.1, you agree to pay any contributions that we require you make for expenditure to the local or regional cooperatives or that may be otherwise approved by these cooperatives or for local advertising if no cooperative exists. DPI will not obligate you under the terms of this Paragraph 13.2 to contribute more than an additional one percent (1%) of the royalty sales of the Store for advertising and promotion conducted in connection with these programs, provided, however, that nothing contained in this Paragraph 13.2 shall limit, affect or supersede any obligation on your part to contribute more than an additional one percent (1%) of the royalty sales of the Store pursuant to any separate agreement or understanding you may have with any such local or regional advertising or promotional cooperative. We reserve the right to engage the services of an advertising source or sources to formulate, develop, produce and

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statements must be prepared in accordance with generally accepted accounting principles by an accountant in the manner prescribed by us;

(d) if you are in default under any of the terms or conditions of this Agreement, statements submitted on a quarterly basis affirming

that all federal, state and local taxes have been paid;

(e) upon our written request, exact copies of your federal and state income tax returns and state sales tax or equivalent tax returns for any period; and

(f) such other information as we may reasonably require to determine you and your owners' compliance with this Agreement or to assist you in the operation of the Store or to otherwise evaluate the performance of the Store.

14.3 ***Right to Require Audit.*** We reserve the right to audit or cause to be audited the sales reports, financial statements and tax returns you are required to submit to us. In the event any audit discloses an understatement of the royalty sales of the Store for any period or periods, you must immediately pay on the amount of such understatement the royalty fee of five and one-half percent (5-1/2%), all advertising contributions due under this Agreement and the amount, if any, required to be paid to your local or regional cooperative as provided in this Agreement, plus interest due. Further, in the event such understatement for any period or periods shall be two percent (2%) or more of the royalty sales of the Store or such inspection or audit is made necessary by your failure to furnish reports, supporting records, financial statements or other information required by this Agreement or to furnish these reports, records, information or financial statements on a timely basis, you will be obligated to reimburse us for the cost of the audit, including the charges of any independent certified public accountant used and the travel expenses, room and board and compensation of our employees. In the event you dispute the

results of any audit conducted by us or our representatives, we will give you the right to have the results verified by an independent certified public accounting firm selected by our outside accounting firm. The expense of this audit shall be borne by you unless this further audit discloses that no deficiency is due in which case we will be obligated to pay for the audit. This audit shall be commenced within ten (10) days after completion of our initial audit. You agree to cooperate with all personnel conducting the audit. The results shall be binding upon the parties. You agree to pay any deficiencies within five (5) days after receipt of the final audit.

15. OPERATING REQUIREMENTS.

15.1 ***Operating Procedures.*** You agree to fully comply with all specifications, standards and operating procedures and rules from time to time prescribed for the operation of a Domino's Pizza Store, including, but not limited to, specifications, standards and operating procedures and rules relating to:

(a) the safety, maintenance, cleanliness, sanitation, function and appearance of the Store premises and its equipment, fixtures, furniture, decor and signs;

(b) qualifications, dress, grooming, general appearance and demeanor of you and your employees;

(c) quality, taste, portion control and uniformity, and manner of preparation and sale, of all pizza and beverage products sold by the

Store and of all ingredients, supplies and materials used in the preparation, packaging and sale of these items;

(d) methods and procedures relating to receiving, preparing and delivering customer orders;

(e) the hours during which the Store will be open for business;

(f) use and illumination of exterior and interior signs, posters, displays, menu boards and similar items; and

(g) the handling of customer complaints.

15.2 ***Compliance with Laws and Other Business Practices.*** You agree to secure and maintain in force all required licenses, permits and certificates and operate the Store in full compliance with all applicable laws, ordinances and regulations. You also agree to pay when due all amounts payable pursuant to any provision of this Agreement or any other agreement with us or our affiliates or subsidiaries or pursuant to any agreement with any other creditor or supplier of the Store. Furthermore, if you are subject to any withholding taxes on royalty fees or other payments due, you shall provide us with quarterly evidence that such tax has been remitted to the appropriate governmental agency on a quarterly basis.

15.3 ***Prices To Be Determined By Franchisee.*** We may from time to time offer guidance to you relative to prices for the products and services of the Store that in our judgment constitute good business practice. You will have the sole right to determine the prices to be charged from time to time by the Store, including the prices

charged in connection with any promotions or advertising programs sponsored by DPI. No such guidance shall be deemed or construed to impose upon you any obligation to charge any fixed, minimum or maximum prices for any product or service offered for sale by the Store. You agree, however, to charge the same price for products offered by the Store whether delivered or sold over the counter in the Store.

15.4 ***Operating Manual***. We will loan to you during the term of the franchise one or more copies of an operating manual or operational bulletins or similar materials containing mandatory and suggested specifications, standards and operating procedures and rules prescribed from time to time by us and information relative to your other obligations under this Agreement and the operation of the Store (the "Operating Manual"). The entire contents of the Operating Manual will remain confidential and our property. We will have the right to add to and otherwise modify the Operating Manual from time to time, if deemed necessary to improve the standards of service or product quality or the efficient operation of the Store, to protect or maintain the goodwill associated with the Marks or to meet competition. No such addition or modification, however, shall alter your fundamental status and rights under this Agreement. The provisions of the Operating Manual as modified from time to time and the mandatory specifications, standards and operating procedures and rules prescribed from time to time by us and communicated to you in writing, will constitute provisions of this Agreement as if contained in this Agreement.

15.5 ***New Concepts.*** If you develop any new concept, process or improvement or any slogan in the operation or promotion of the Store, you agree to promptly notify us and provide us with all necessary information without compensation. You acknowledge that any such concept, process, improvement or slogan shall become our property and that we may utilize or disclose this information to other franchisees.

15.6 ***Franchisee Must Directly Supervise Store.*** The Store shall at all times be under the direct, on-premises supervision of you (or the controlling shareholder or partner if you are a corporation or partnership). You (or the controlling shareholder or partner if you are a corporation or partnership) must devote your full time and efforts (excluding reasonable vacation periods) as manager of the Store or to the management of other Domino's Pizza Stores (or other related activities approved by us in accordance with Paragraph 7.1 of this Agreement). Further, neither you nor any of your owners may, during the term of this Agreement, engage in any other business activity without our prior written consent, If you own more than one (1) Store, each Store must also be under the direct, on-premises supervision of a manager:

(a) who has been properly trained by you;

(b) whose identity has been disclosed to us; and

(c) who shall have executed, upon our request, an agreement in the form provided by us agreeing not to divulge any trade secret or confidential or proprietary information, including the contents of the Operating Manual, or to

engage in or have any interest in any other carry-out or delivery pizza store business.

15.7 ***Insurance.*** You shall at all times during the term of the franchise maintain in force at your sole expense:

(a) property insurance on a replacement cost basis at a minimum limit based on the total value of your assets (including, but not limited to, fire, extended coverage, vandalism and malicious mischief),

(b) primary general liability insurance with a minimum limit of $1,500,000.00 (including, but not limited to, coverage for personal injury, products and contractual liability),

(c) primary automobile liability insurance with a minimum limit of $1,500,000.00 (including, but not limited to, owned automobiles titled or leased in the name of you or your owners and used at any time, whether principally or occasionally in your business, hired and non-owned coverage). If you or your owners do not use a vehicle owned or leased in the name of you or any of your owners in your business, you must provide written evidence of that fact, satisfactory to us.

(d) workers compensation insurance (in your name) as required by applicable law. If no such law exists, then you must obtain such workers compensation insurance as required by us. If your state recognizes and permits self insurer programs, your participation in such a program will satisfy our requirements under this subparagraph (d). If deductible plans are approved and used in your state, coverage may

be purchased on this basis subject to the requirements of your insurance carrier.

All insurance policies must be issued by an insurance carrier rated A or better by Alfred M. Best & Company, Inc. All liability insurance policies must name us, and any subsidiaries and affiliates which we designate, as additional insured entitled to the coverage afforded to all named insureds, without regard to any other insurance or self-insured program which we may have in effect, and also provide that we receive thirty (30) days prior written notice of termination, expiration, cancellation, modification or reduction in coverage or limits of any such policy. We may also reasonably increase the minimum liability "limit" protection requirement annually and require different or additional kinds of insurance to reflect inflation, changes in standards of liability, higher damage awards in public, product or motor vehicle litigation or other relevant changes in circumstances. You must submit to us annually a copy of the certificate of insurance or evidence of the renewal or extension of each such insurance policy or any modifications to any such insurance policies. If at any time you fail or refuse to maintain in effect any insurance coverage required by us, or to furnish satisfactory evidence of such insurance, we may, at our option and in addition to other rights and remedies we may have, obtain insurance coverage, on your behalf, and you agree to promptly execute any applications or other forms or instruments required to obtain any such insurance and pay to us on demand any cost and premiums incurred by us. Your obligation to obtain and maintain the insurance described in this Agreement shall not be

limited in any way by reason of any insurance maintained by us.

15.8 ***Identification as Franchisee.*** You agree to exhibit (a) on the Store premises and (b) on all delivery vehicles (or on car top signs on all delivery vehicles) signs of sufficient prominence and wording as we may prescribe from time to time so as to advise the public that the Store is owned, operated and maintained by you and that each such delivery vehicle is owned, operated and maintained by you or the driver of the vehicle, as the case may be.

16. MARKS.

16.1 ***Usage.*** You acknowledge that we are the owner of all Marks licensed to you by this Agreement and that all usage of the Marks and any goodwill established shall inure to our exclusive benefit. You shall use the Marks in full compliance with rules prescribed from time to time by us. Any unauthorized use of the Marks will constitute a breach of this Agreement and an infringement of our rights in and to the Marks. You will not use any Mark as part of any corporate name or with any prefix, suffix or other modifying words, terms, designs or symbols nor may you use any Mark in connection with the sale of any unauthorized product or service or in any other manner not explicitly authorized in writing by us. All provisions of this Agreement applicable to the Marks will apply to any additional proprietary trademarks and commercial symbols we hereafter authorize you to use.

16.2 ***Infringements.*** You agree to immediately notify us of any infringement of or challenge to your or our use of any Mark or claim by any person of any rights in any

Mark. You agree that you will not communicate with any person other that us and our counsel in connection with any such infringement, challenge or claim. We will have sole discretion to take such action as we deem appropriate and the right to exclusively control any litigation or Patent and Trademark Office or other proceeding arising out of any infringement, challenge or claim or otherwise relating to any Mark. You agree to execute any and all instruments and documents, render such assistance and do such acts and things as may, in the opinion of our counsel, be necessary or advisable to protect and maintain our interests in any such litigation or Patent and Trademark Office or other proceeding or to otherwise protect and maintain our interest in the Marks.

16.3 ***Indemnification***. We will indemnify you against and reimburse you for all damages for which you are held liable in any proceeding arising out of the use of any Mark in compliance with this Agreement. If it becomes advisable at any time in our sole discretion for you to modify or discontinue use of any Mark and/or use one or more additional or substitute Marks, you agree to do so and our sole obligation will be to reimburse you for your tangible costs of complying with this obligation.

17. INSPECTIONS.

We will have the right at any time during business hours and without prior notice to conduct reasonable inspections of the Store and its business records wherever located and to take a physical inventory of the assets of the Store. Inspections of the Store will be made at our expense, unless we are required to make any additional

inspections in connection with your failure to comply with this Agreement. In such event, we will have the right to charge you for the costs of making all additional inspections in connection with your failure to comply, including without limitation the travel expenses, room and board and compensation of our employees.

18. TERMINATION AND EXPIRATION.

18.1 ***Termination By Franchisee.*** If you are in compliance with this Agreement and we breach this Agreement and fail to cure any breach within thirty (30) days after written notice is delivered to us, you may terminate this Agreement and the franchise effective ten (10) days after delivery of notice to us. A termination of this Agreement and the franchise by you without complying with these requirements or for any reason other than our breach of this Agreement and our failure to cure the breach within thirty (30) days after receipt of written notice from you shall be deemed a termination by you without cause and not in accordance with the provisions of this Agreement.

18.2 ***By DPI.*** We shall have the right to terminate this Agreement effective upon delivery of notice of termination to you, if:

(a) you or any of your owners have made any material misrepresentation on your application for the franchise;

(b) you do not open the Store within six (6) months from the date of this Agreement;

(c) you or any of your owners is judged a bankrupt, becomes insolvent, makes an assignment for the benefit of creditors, is unable to pay his debts as they become due, or a petition under any bankruptcy law is filed against you or any of your owners or a receiver or other custodian is appointed for a substantial part of the assets of the Store;

(d) you abandon or fail to continuously and actively operate the Store;

(e) the lease or sublease for the Store is terminated or canceled or you are unable to renew or extend the lease or sublease or you fail to maintain possession of the Store premises unless you are permitted to relocate the Store under Paragraph 7.2 of this Agreement;

(f) you or any of your owners is convicted of a felony, or a crime which substantially impairs the goodwill associated with the Marks or you or any of your owners engages in any conduct which, in our judgment, adversely affects the reputation of the Store or the goodwill associated with the Marks;

(g) you intentionally underreport the royalty sales of the Store for any period or periods;

(h) you or any of your owners violates any of the restrictions contained in Paragraph 20 or 21 of this Agreement;

(i) you intentionally or on more than one occasion during the term of this Agreement, violate any Child Labor Laws in connection with your operation of the store;

(j) an audit by us discloses an understatement of royalty sales and you fail to pay to us

the applicable royalty fee and advertising contribution and interest due within five (5) calendar days after receipt of the final audit report;

(k) the interest of a deceased or permanently disabled person is not disposed of in accordance with the terms of this Agreement;

(l) any other franchise agreement between you or your owners and DPI is terminated by us for cause;

(m) you fail to obtain or maintain insurance required by us and you do not correct this failure within forth-eight (48) hours after written notice is delivered to you; provided, however, that we shall not exercise its right to terminate this Agreement if you immediately cease operating the Store and obtain all such insurance within ten (10) days after written notice is delivered to you;

(n) you fail to comply with any provision of this Agreement or any specification, standard or operating procedure or rule prescribed by us which relates to the use of any Mark or the quality of pizza or any beverage sold by you or the cleanliness and sanitation of the Store and you do not correct this failure within seven (7) calendar days after written notice is delivered to you;

(o) you fail to pay when due any amount owed to us, our affiliates or subsidiaries, or any creditor or supplier of the Store or any taxing authority for federal, state or local taxes (other than amounts being bona fide disputed through appropriate proceedings) and you do not correct such failure within ten (10) calendar days after written notice is delivered to you;

(p) you or any or your owners fails to comply with any other provision of this Agreement or any specification, standard or operating procedure and fail to correct this failure within thirty (30) calendar days after written notice is delivered to you; or

(q) you or any of your owners fail on three (3) or more occasions during any one (1) year period to comply with any one or more provisions of this Agreement including without limitation, your obligation to submit when due, sales reports or financial statements, to pay when due the royalty fees, advertising contributions or other payments to us or our affiliates or subsidiaries or any other creditors or suppliers of the Store, whether or not such failure to comply is corrected after notice is delivered to you.

18.3 ***Obligations Upon Termination or Expiration.*** Upon termination or expiration of this Agreement, you agree to:

(a) immediately return to us all copies of the Operating Manual and cease use of and deliver to DPI all Customer Lists (as hereinafter defined in paragraph 20.5);

(b) take such action as may be required to cancel all assumed name or equivalent registrations relating to the use of any Mark;

(c) notify the telephone company and all listing agencies of the termination or expiration of your right to use all telephone numbers and all classified and other directory listings relating to the Store and to authorize transfer of these to us or our franchisee or designee. You acknowledge that we have the sole rights to and interest in all telephone numbers and directory listings

relating to any Mark, and you authorize us to direct the telephone company and all listing agencies to transfer all telephone numbers and directory listing to us, our franchisee or designee and if you fail or refuse to do so, the telephone company and all listing agencies may accept our direction as evidence of our exclusive rights in the telephone numbers and directory listings and our authority to direct the transfer;

(d) immediately pay all royalty fees, advertising contributions and other charges which are due and owing under this Agreement;

(e) immediately cease identifying yourself as a Domino's Pizza Store or as being associated with the Domino's System;

(f) if you retain possession of the Store premises, at your expense, make such reasonable modifications to the exterior and interior decor of the Store as we require to eliminate its identification as a Domino's Pizza Store;

(g) make the Store accessible and available for us to operate pursuant to Paragraph 19.9 of this Agreement if we elect to do so.

19. OPTION TO PURCHASE STORE.

19.1 ***Option***. Upon the termination or expiration of this Agreement, except termination by you for cause, we shall have the option, but not the obligation, exercisable for thirty (30) days, to purchase the assets of the Store. For purposes of this paragraph, the term "assets" shall mean the equipment, inventory, leasehold interests and improvements and favorable rights and covenants of the Store, but exclusive of delivery vehicles.

19.2 ***Formula Price.*** The purchase price for these assets and the covenants shall be equal to twenty-five percent (25%) of the first Three Hundred Thousand Dollars ($300,000.00) of royalty sales ("base Amount") of the Store during the twelve (12) calendar months immediately preceding the date of termination or expiration plus thirty-five (35%) of royalty sales in excess of the Base Amount during this period. The purchase price shall be allocated among the assets and covenants in the manner prescribed by us.

If the Store has been in operation less than twelve (12) months, the option price shall be the cost of the Store plus ten percent (10%). The term "cost" shall be defined as your documented expenditures for the equipment, inventory and leasehold improvements of the Store, but shall not include any charge for labor performed by you or your family members in connection with the development of the Store.

19.3 ***Purchase of Commissary.*** In the event you operate a commissary in connection with the Store, we shall also have the option to purchase the assets of the commissary. The purchase price for the assets of the commissary will be the net book value (based upon a seven year depreciation schedule).

19.4 ***Deductions From Purchase Price.*** In the event we elect to purchase the assets of the Store, the purchase price will be reduced by:

(a) the total current and long term liabilities of the Store assumed by us as described below.

(b) the amount necessary to upgrade and renovate the Store to meet our then current standards for a Domino's Pizza Store.

We will assume all current and long term liabilities, whether or not included on your financial statements up to the amount of the purchase price subject, however, to all defenses available to you. Further, the amount we charge for upgrading and renovating the Store will not exceed one and one-half percent (1-1/2%) of the royalty sales of the Store from the date of opening to the date of termination or expiration reduced by an amount equal to the total expenditures made by you for renovation and upgrading of the Store at our request up to the date of termination or expiration.

19.5 ***Payment of Purchase Price.*** The balance of the purchase price, after deductions described above will be payable as follows: ten percent (10%) of the balance at the time of closing and the remainder in sixty (60) equal monthly installments of principal plus interest at a rate of interest per annum equal to the prime lending rate charged by the National Bank of Detroit determined as of the closing date with annual adjustments based on the prime rate charged on each anniversary date. The first payment will be due on the first day of the second succeeding calendar month following closing and the remaining payments on the first day of each month thereafter. On the first payment date, interest from the date of closing shall also be paid. If we elect to pay the entire purchase price at closing, we shall have the right to escrow such portion of the purchase price as we deem appropriate for a period of six (6) months to cover liabilities of the Store. We shall notify you of claims asserted

by creditors of the Store against the escrow monies. You shall have forty-eight (48) hours to settle any claim with such creditor prior to our disbursement of funds from the escrow. If there is a good faith dispute between you and a creditor of the Store, you shall have thirty (30) days to reach a settlement with any such creditor as to the amount owed before we will disburse any escrow monies to such creditor. If you are unable to resolve the discrepancy with the creditor within the thirty (30) day period, we shall have the right to use the escrow monies to satisfy the claim of any such creditor. At the end of such six (6) month period, any remaining purchase price shall be remitted to you along with a statement prepared by DPI indicating the manner in which these funds were expended.

19.6 ***Real Property***. In the event you or your owners own the real property on which the Store or commissary is located, we will also have the option to purchase this property for a period of thirty (30) days following expiration or termination of this Agreement. The purchase price will be the fair market value as determined by an independent appraiser selected by both of us. If we cannot agree on the independent appraiser, we each shall select an independent appraiser who shall select a third independent appraiser. The independent appraiser selected by our appraisers shall determine the fair market value of the real property and his determination shall be final and binding on the parties. The purchase price will be payable in full at the closing minus customary prorations including the pay-off of existing mortgage liens. If we do not elect to purchase the real property, we or our designee will have the option to enter into a lease for a

term of not less than five (5) years with an option by the lessee to extend the term of the lease for an additional term of five (5) years. The lease shall contain the terms and conditions contained in the form of lease then used by us in connection with Domino's Pizza Stores owned and operated by us. The rental under the lease for the initial five (5) year term shall be the fair rental value of the property as determined by an independent appraiser selected in the manner described above. The rental shall be increased during the second five (5) year option term by the percentage that the National Consumer Price Index for Urban Wage Earnings and Clerical Workers as determined by the United States Department of Labor for the region in which the Store is located (or a comparable index if such Index is not then being issued) has increased from the commencement date of the initial term until the last day of the initial term of the lease.

19.7 ***Closing***. The closing shall occur within thirty (30) days after we exercise our option to purchase the assets and/or real property or such later date as may be necessary to comply with applicable bulk sales or similar laws. At the closing, we both agree to execute and deliver all documents necessary to vest title in the purchased assets and/or real property in us free and clear of all liens and encumbrances, except those assumed by us and/or to effectuate the lease of the Store premises. You also agree to provide us with all information necessary to close the transaction. We reserve the right to assign our option to purchase the Store or commissary, if any, operated in connection with the Store (and the real property to the extent applicable) or designate a substitute purchaser for the Store. We agree, however, to be responsible for and

shall guarantee payment of any deferred portion of the purchase price as provided in Paragraph 19.6 of this Agreement in the event we designate a substitute purchaser of the assets of the Store. If you do not execute and deliver any documents required, by execution of this Agreement you irrevocably appoint us as your lawful attorney-in-fact with full power and authority to execute and deliver in your name all these documents. You also agree to ratify and confirm all of our acts as your lawful attorney-in-fact and to indemnify and hold us harmless from all claims, liabilities, losses or damages suffered by us in so doing.

19.8 ***Operation During Option Period.*** We will have the right, upon written notice to you, to manage the Store during the period in which we have the option to purchase the Store upon termination or expiration of this Agreement and for the period following the exercise of our option and prior to the closing on the same terms and conditions as described in Paragraph 21.7.

19.9 ***Formula Price.*** The parties agree that the formula price described in this Paragraph 19 is the agreed upon method of arriving at a price for the assets of the Store in the event we exercise the option contained in this Paragraph 19 and is not to be deemed a conclusive indication of the value of the Store under other circumstances of where an agreement to purchase the Store has been negotiated by you or your owners.

20. RESTRICTIVE COVENANTS.

20.1 ***In-Term Covenant***. You agree that, during the term of this Agreement, you will not, directly or indirectly for the benefit of you or your owners, or through or on behalf of or in conjunction with any other person, partnership or corporation, own, engage in, be employed by, advise, assist, invest in, franchise, make loans to, or have any other interest, whether financial or otherwise, in other carry-out or delivery pizza store business (except for other Domino's Pizza Stores operated under franchise agreements entered into with us or other Domino's Pizza Stores in which you or your owners have an ownership interest).

20.2 ***Post-Term Covenant***. You agree that, for a period of one (1) year after termination or expiration of this Agreement, or the date on which you cease to operate the Store, whichever is later, you will not, directly or indirectly for the benefit of you or your owners, or through or on behalf of or in conjunction with any other person, partnership or corporation, own, engage in, be employed by, advise, assist, invest in, franchise, make loans to, or have any other interest, whether financial or otherwise, in any carry-out or delivery pizza store business located at the premises of the Store or within ten (10) miles of the premises of the Store (except for other Domino's Pizza Stores operated under franchise agreements with us or other Domino's Pizza Stores in which you or your owners shall have an ownership interest). The covenant contained in this paragraph shall not be deemed to impair, modify or change any covenant not to compete contained in any agreement for the purchase and sale of the Store.

20.3 ***Ownership of Public Companies.*** The covenants contained in this Paragraph 20 shall not apply to ownership of less than a five percent (5%) beneficial interest in the outstanding equity securities of any corporation whose stock is publicly traded.

20.4 ***Solicitation of Employees.*** You agree that during the term of this Agreement you will not, directly or indirectly, solicit or employ any person who is employed by us, by any entity controlled by us or by any other of our franchisees, nor will you induce or attempt to induce any of these people to leave their employment without the prior written consent of their employers. We agree that we will not induce or attempt to induce any of your employees to leave their employment with you and become employed with us or our affiliates without your consent.

20.5 ***Customer Lists and Trade Secrets; New Processes, Concepts, Improvements, Etc.*** You agree to maintain the absolute confidentiality of the Operating Manual and all other information concerning the Domino's System during and after the term of the franchise, disclosing this information to the other employees of the Store only to the extent necessary for the operation of the Store in accordance with this Agreement, and that you will not use the Operating Manual or such other information in any other business or in any manner not specifically authorized or approved by us in writing. The customer lists and all historical data relating to the sale of all pizza and beverage products at the Store (the "Customer Lists") also shall be deemed confidential and (a) you hereby acknowledge that the Customer Lists are a valuable asset of DPI; (b) you shall not use the Customer Lists in any

other business or capacity; and (c) you shall maintain the absolute secrecy and confidentiality of the Customer Lists.

20.6 ***Owners of Corporation or Partnership.*** If you are a corporation or partnership, the owners, by executing this Agreement, shall be bound by the provisions contained in this Agreement, including the restrictions set forth in this Paragraph 20. Further, a violation of any of the provisions of this agreement, including the covenants contained in this Paragraph 20, by any owner shall also constitute a violation by you of your obligations under this Agreement.

21. ASSIGNMENT.

21.1 ***By DPI.*** This Agreement is fully assignable by us and the assignee or other legal successor to our interests will be entitled to all of the benefits of this Agreement.

21.2 ***By Franchisee.*** This Agreement is personal to you and your owners (if you are a corporation or partnership). accordingly, neither you nor any of your owners may assign or transfer this Agreement, any interest in this Agreement or, if you are a corporation or partnership, any interest in the corporation or partnership except as specifically authorized under this Agreement. A transfer of ownership of the Store (or its assets) may only be made in conjunction with a transfer of this Agreement. Any attempted assignment or transfer not in accordance with this Agreement shall have no effect and shall constitute a breach of this Agreement.

21.3 ***Assignment to Corporation or Partnership.*** We will allow you to assign this Agreement and the Store (and its assets) to a corporation or partnership for the convenience of ownership of the Store, provided:

(a) the corporation or partnership conducts no business other than the operation of the Store or other Domino's Pizza Stores (or other related activities authorized under this Agreement);

(b) the corporation or partnership is actively managed by you;

(c) the person designated as the controlling shareholder or partner owns and controls not less than fifty-one percent (51%) of the general partnership interest of such partnership or the equity and voting power of all issued and outstanding capital stock of such corporation; and

(d) all shareholders and partners meet our requirements as established from time to time by us and agree to guarantee the obligations of the corporation or partnership under this agreement and to be bound by the terms of this Agreement in the manner prescribed by us.

If you are a corporation or partnership or if this Agreement is assigned to a corporation or partnership, you must comply with the requirements set forth in this Paragraph 21.3 throughout the term of this Agreement. The articles of partnership or the organization documents of any partnership or corporation owning the franchise, including all stock certificates, shall recite that they are subject to all restrictions contained in this Agreement. We shall also have the right to require, as a condition of any

assignment of this Agreement to a corporation or partnership or the operation of the franchise by a corporation or partnership, that the shareholders or partners enter into a buy/sell agreement among themselves in a form and containing such terms as we prescribe for transfers of ownership interests in such corporation or partnership. You shall provide us with all documents to be executed in connection with any such assignment and we shall use our reasonable efforts to approve or disapprove these within thirty (30) days after receipt.

21.4 ***Assignment or Transfer to Others.*** We will permit sales, transfers or assignments of this Agreement or, if you are a corporation or partnership, an ownership interest in the corporation or partnership to others provided:

(a) you (and your owners) are not in default under this Agreement or any other agreement with us or our subsidiaries or affiliates or any other creditor or supplier of the Store;

(b) the proposed transferee or assignee (and its controlling shareholder or partner and all other owners if it is a corporation or partnership) meets our then-applicable standards for franchisees or owners;

(c) the proposed transferee or assignee (and its owners) is not operating any other carry-out or delivery pizza store business except other Domino's Pizza Stores;

(d) the proposed transferee or assignee (and its owners if it is a corporation or partnership) must sign our then-current form of standard franchise agreement for a term equal to the

remaining term of this Agreement or, at our election, the then-current term of longer;

(e) the proposed transferee or assignee (or the person designated by us) must complete all required training to the extent required by us;

(f) at our request, the proposed transferee or assignee refurbishes the Store in the manner and subject to the provisions prescribed in Paragraph 9; and

(g) the proposed transferee or assignee pays us a transfer fee of $1,500.00.

The provisions of (d), (e), (f) and (g) above shall not apply to an approved sale, transfer or assignment by a shareholder or partner owning a forty-nine percent (49%) or less interest in the corporation or partnership except that the proposed transferee or assignee must guarantee the performance by Franchisee of its obligations under this Agreement and agree to be bound by all of the provisions of this Agreement in the form prescribed by us. You must provide us with all documents to be executed by you and/or your owners and the proposed purchasers in connection with any transfer or assignment at least thirty (30) days prior to signing.

21.5 ***Death or Permanent Disability.*** Upon your death or permanent disability or the death or permanent disability of the controlling shareholder or partner, this Agreement or the ownership interest of such deceased or permanently disabled shareholder or partner must be transferred to a party approved by us. Any transfer, including, without limitation, transfers by devise or inheritance or trust provisions, shall be subject to the same conditions for transfers which are contained in this

Agreement. Except as otherwise prescribed by us in writing, your personal representative or the personal representative of such shareholder or partner shall submit to DPI a proposal meeting the requirements for transfer of this Agreement or such ownership interest within one hundred and twenty days (120) days of your death or permanent disability or the death or permanent disability of such shareholder or partner. DPI agrees to communicate its approval or disapproval of any such proposal within fifteen (15) days of receipt. DPI will not unreasonably withhold its consent to the transfer of this Agreement or such ownership interest to your spouse, heirs or relatives or the spouse, heirs or relatives of such deceased or permanently disabled shareholder or partner, provided the requirements of Paragraph 21.4 are satisfied. DPI agrees to make its Board of Directors and Executive Team (or its successor) available during such one hundred and twenty (120) day period to evaluate any proposal regarding transfer of this Agreement or such ownership interest, including any request that DPI consider purchasing the franchise or such ownership interest. Your personal representative or the personal representative of such deceased or permanently disabled shareholder or partner shall complete the transfer of this Agreement or such ownership interest within sixty (60) days from the date of DPI's approval of any such proposal. Upon the death of any other owner, the interest of such owner shall be transferred within a reasonable time to a person meeting our requirements. All such transfers must also comply with Paragraph 21.4 of this Agreement. Your or any of your owners' failure to transfer the interest in accordance

with the provisions of this Paragraph shall be considered a breach of this Agreement.

21.6 ***Definition of Permanent Disability.*** You or your controlling shareholder or partner will be deemed to have a "permanent disability" if your or your controlling shareholder's or partner's usual, active participation in the Store as contemplated by this Agreement is for any reason curtailed for a continuous period of six (6) months.

21.7 ***Operation by DPI After Death or Permanent Disability.*** We shall have the right to appoint a manager for the Store if in our judgment the Store is not being managed properly after your death or permanent disability or the death or permanent disability of the controlling shareholder or partner. All funds from the operation of the Store during the management by our appointed manager will be kept in a separate fund, and all expenses of the Store including compensation, other costs, and travel and living expenses of our manager will be charged to this fund. We will charge a management fee of five and one-half percent (5½%) (in addition to the royalty fee and advertising contributions payable under this Agreement) during the period in which we manage the Store on your behalf. In managing the Store, our obligation will be to use our reasonable efforts and we will not be liable for any debts, losses or obligations of the Store, to any or of your creditors for any products, materials, supplies or services purchased by the Store prior to or during the time of management by our manager. If the fund which we maintain is insufficient to pay the expenses of the Store, we will notify you or your executor, administrator,

conservator or other personal representative and this person must deposit in the fund within five (5) business days, any amount required by us to attain a reasonable balance in the fund.

21.8 ***Right of First Refusal of DPI.*** If you or your owners propose to sell the Store (or its assets) or, if your [sic] are a corporation or partnership, any ownership interest in the corporation or partnership and you or your owners obtain a bona fide, executed written offer to purchase this interest, you or your owners are obligated to deliver a copy of the bona fide offer to us along with all documents to be executed by you or your owners and the proposed assignee or transferee. We will, for a period of thirty (30) days from the date of delivery of this offer to us, have the right, exercisable by written notice to you or your owners, to purchase the Store (or its assets) or such ownership interest for the price and on the terms and conditions contained in the offer. We may substitute equivalent cash for any form of payment proposed in such offer or designate a substitute purchaser for the Store (or the assets) or the ownership interest being offered, provided that we will assume responsibility for the performance of any other purchaser we may designate. If the offer is to purchase the interest of a controlling shareholder or partner and is for less than all of the outstanding interests of the corporation or partnership, we shall also have the right, during such thirty (30) day period upon written notice to the other owners, to purchase the remaining shares of capital stock or partnership interest at a per share or per unit or interest price equivalent to the price being offered under the bona fide offer to

the controlling shareholder or partner. If we do not exercise this right of first refusal, the offer may be accepted by you or your owners, subject to our prior written approval as provided in this Agreement. If the offer is not accepted within sixty (60) days, we will again have the right of first refusal to purchase the Store as described above. This paragraph will not apply to transfers made in accordance with Paragraph 21.3 of this Agreement.

22. CONTRACT INTERPRETATION AND ENFORCEMENT.

22.1 ***Effect of Waivers.*** No waiver by us of any breach or a series of breaches of this Agreement shall constitute a waiver of any subsequent breach or waiver of the performance of any of your obligations under this Agreement. Our acceptance of any payment from you or the failure, refusal or neglect by us or you to exercise any right under this Agreement or to insist upon full compliance with our or your obligations under this Agreement or with any specification, standard or operating procedure or rule will not constitute a waiver of any provision of this Agreement.

22.2 ***Cost of Enforcement.*** If we institute any legal or equitable action against you to secure or protect our rights under or to enforce the terms of this Agreement, in addition to any judgment entered in our favor, we shall be entitled to recover such reasonable attorney's fees as we may have incurred together with court costs and expenses of litigation.

22.3 ***Indemnification of DPI.*** If we or any of our subsidiary or affiliated companies or any of our or their agents or employees are subjected to any claim, demand

or penalty or become a party to any suit or other judicial or administrative proceeding by reason of any claimed act or omission by you, your employees or agents, or by reason of any act occurring on the Store premises, or by reason of an omission with respect to the business or operation of the Store, including but not limited to making a delivery or returning from making a delivery, you shall indemnify and hold us, our subsidiary and affiliated companies, or any of our or their agents or employees, harmless against all judgments, settlements, penalties, and expenses, including attorney's fees, court costs and other expenses of litigation or administrative proceeding, incurred by or imposed on us, our subsidiary and affiliated companies, or any of our or their agents or employees, in connection with the investigation or defense relating to such claim or litigation or administrative proceeding. Your indemnification obligations described above will continue in full force and effect after, and notwithstanding, the expiration or termination of this Agreement.

22.4 ***Construction and Severability.*** All references in this Agreement to the singular shall include the plural where applicable, and all references to the masculine shall include the feminine and vice-versa. If any part of this Agreement for any reason shall be declared invalid, such decision shall not affect the validity of any remaining portion, which shall remain in full force and effect. If any applicable law or rule requires a greater prior notice of the termination of or election not to renew this Agreement, or the taking of some other action than is required

under this Agreement, the prior notice or other requirements required by this law or rule shall be substituted for the requirements of this Agreement.

22.5 ***Scope and Modification of Agreement.*** This Agreement constitutes the entire agreement between the parties and supersedes all prior and contemporaneous, oral or written, agreements or understandings of the parties regarding the subject matter of this Agreement. No modification, waiver, termination, rescission, discharge or cancellation of this Agreement shall affect the right of any party to enforce any claim or right under this Agreement, whether or not liquidated, which occurred prior to the date of such modification, waiver, termination, rescission, discharge or cancellation.

22.6 ***Governing Laws.*** The terms and provisions of this Agreement shall be interpreted in accordance with and governed by the laws of the State in which the Store is located.

22.7 ***Notices.*** All written notices permitted or required to be delivered by the provisions of this Agreement or of the Operating Manual shall be deemed so delivered when delivered to you by hand or three (3) days after having been placed in the United States mail by Registered or Certified Mail, and addressed to us at our most current principal business address or to you at the most current principal business address or home address of which we have been notified in writing.

22.8 ***Independent Contractors.*** The parties to this Agreement are independent contractors and no training, assistance or supervision which we may give or offer to you shall be deemed to negate such independence. We

shall not be liable for any damages to any person or property arising directly or indirectly out of the operation of the Store, including but not limited to those damages which which may occur while your employees are making or returning from making deliveries. Nor shall we have any liability for any taxes levied upon you, your business, or the Store. The parties further acknowledge and agree the relationship created by this Agreement and the relationship between us and the relationship between DPI and your employees is not a fiduciary relationship nor one of principal and agent.

22.9 ***Standard of Reasonableness.*** Unless otherwise stated in this Agreement, we agree to exercise reasonable judgment with respect to all determinations to be made by us under the terms of this Agreement.

22.10 ***Acknowledgement.*** You acknowledge that you have conducted an independent investigation of the business contemplated by this Agreement and recognize that it involves business risks making the success of the venture largely dependent upon your business abilities. We expressly disclaim the making of, and you acknowledge that you have not received or relied upon, any warranty or guarantee, express or implied, as to the potential volume, profits or success of the business venture contemplated by this Agreement.

22.11 ***Binding Effect.*** This Agreement is binding upon the parties and their heirs, approved assigns and successors in interest.

22.12 *Effective Date of this Agreement.* This Agreement shall become effective upon the date of its acceptance and execution by us.

DOMINO'S PIZZA, INC.

By: _____
Linda T. Popevich

Its: Divisional Vice President of Franchise Services

DATED: _____

FRANCHISEE:

_____

_____

_____

DATED: _____

DATE OF STORE OPENING/RENEWAL DATE/ DATE OF STORE TRANSFER:

_____

COVENANTS OF SHAREHOLDERS/PARTNERS.

The undersigned individuals represent and warrant that they are all of the shareholders, partners of Franchisee or otherwise have a direct or indirect beneficial interest in the success of Franchisee. Accordingly, to induce DP1 to enter into this Agreement and grant the franchise to Franchisee, each of the undersigned individuals hereby jointly and severally guarantees the performance by Franchisee of its obligations under this Agreement and each of the undersigned individuals hereby jointly and severally agrees to be bound by all of the provisions of this Agreement including, without limitation, the restrictions contained in Paragraphs 20 and 21 of this Agreement.

CONTROLLING SHAREHOLDER/ PARTNER	SHAREHOLDER/ PARTNER
SHAREHOLDER/ PARTNER	SHAREHOLDER/ PARTNER

§ 1. Trusts, etc., in restraint of trade illegal; penalty

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

§ 2. Monopolizing trade a felony; penalty

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

* * *

§ 14. Sale, etc., on agreement not to use goods of competitor

It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

(2)

Supreme Court, U.S.
FILED
MAR 9 1998
CLERK

No. 97-1134

In The

Supreme Court of the United States

October Term, 1997

BAUGHANS, INC.; BLUE EARTH ENTERPRISES, INC.; KEVIN BORES; CHARLES F. BUCK; DAVIS PIZZA ENTERPRISES, INC.; DIANE A. DAVIS; FISHER PIZZA, INC.; JAMES B. FISHER, JR.; JRW PIZZA; LUGENT PIZZA, INC.; JOSEPH J. LUGENT; SCALE PIZZA, INC.; SPRING GARDEN PIZZA, INC.; BRAD L. WALKER; JAMES R. WOOD; INTERNATIONAL FRANCHISE ADVISORY COUNCIL, INC.,

Petitioners,

vs.

DOMINO'S PIZZA, INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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25 pp

QUESTION PRESENTED

Whether in a federal antitrust action a franchisor's exercise of its contractual right to regulate its franchisees' purchases of supplies can be characterized as "market power" in a "relevant market" encompassing only supplies approved by the franchisor, without regard to the franchisees' contractual remedies and the interchangeability of those supplies with comparable products that have not been approved.

RULE 29(6) STATEMENT

Respondent DPI is a subsidiary of TISM, Inc., a privately owned corporation. DPI has no nonwholly owned subsidiaries.

TABLE OF CONTENTS

	Page
Question Presented	i
Rule 29(6) Statement	ii
Table of Contents	iii
Table of Citations	iv
Statement of the Case	1
A. Factual Background	1
B. Proceedings Below	3
Reasons for Denying the Writ	4
I. The Third Circuit's Decision Is In Accord With *Kodak*.	4
II. There Is No Conflict Among The Circuits.	8
Conclusion	17

TABLE OF CITATIONS

Cases Cited: *Page*

Albrecht v. Herald Co., 390 U.S. 145 (1968) 5

Chicago Prof'l Sports L.P. v. NBA, 95 F.3d 593 (7th Cir. 1996) 9

Collins v. International Dairy Queen, Inc., 939 F. Supp. 875 (M.D. Ga. 1996) 15

Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977) 7

Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752 (1984) 6

Digital Equip. Corp. v. Uniq Digital Techs., Inc., 73 F.3d 756 (7th Cir. 1996) 6, 11, 16

Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451 (1992) ..... *passim*

Grappone Inc. v. Subaru of New England, Inc., 858 F.2d 792 (1st Cir. 1988) 5, 13-14

Heatransfer Corp. v. Volkswagenwerk, A.G., 553 F.2d 964 (5th Cir. 1977) 10

Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984) 6-7

Lee v. Life Ins. Co. of North America, 23 F.3d 14 (1st Cir.), *cert. denied*, 513 U.S. 964 (1994) 8, 13

Citations

	Page
Metrix Warehouse, Inc. v. Daimler-Benz Aktiengesellschaft, 828 F.2d 1033 (4th Cir. 1987) .	15-16
Mozart Co. v. Mercedes-Benz of North America, Inc., 833 F.2d 1342 (9th Cir. 1987)	9-10, 14
New Jersey American, Inc. v. The Allied Corp., 875 F.2d 58 (3rd Cir. 1989)	10
Northern v. McGraw-Edison Co., 542 F.2d 1336 (8th Cir. 1976)	15
Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134 (1968)	6
Photovest Corp. v. Fotomat Corp., 606 F.2d 704 (7th Cir. 1979)	10
Pick Mfg. Co. v. General Motors Corp., 80 F.2d 641 (7th Cir. 1935), *aff'd*, 299 U.S. 3 (1936)	15-16
PSI Repair Servs., Inc. v. Honeywell, Inc., 104 F.3d 811 (6th Cir.), *cert. denied*, __ U.S. __, 117 S. Ct. 2434 (1997)	8, 11-12
Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971)	14
Spectrum Sports, Inc. v. McQuillan, 506 U.S. 447 (1993)	5

Citations

	Page
Standard Oil Co. v. United States, 337 U.S. 293 (1949)	6-7
State Oil Co. v. Khan, __ U.S. __, 118 S. Ct. 275 (1997)	5
Tominaga v. Shepherd, 682 F. Supp. 1489 (C.D. Cal. 1988)	10
United Farmers Agents Ass'n v. Farmers Ins. Exchange, 89 F.3d 233 (5th Cir. 1996), *cert. denied*, __ U.S. __, 117 S. Ct. 960 (1997)	8-10, 11
United States Steel Corp. v. Fortner Enters., Inc., 429 U.S. 610 (1977)	13, 14
Valley Prods. Co., Inc. v. Landmark, 128 F.3d 398 (6th Cir. 1997)	8, 11-12
Virtual Maintenance, Inc. v. Prime Computer, Inc., 11 F.3d 660 (6th Cir. 1993), *cert. dismissed*, 512 U.S. 1216 (1994)	12
Will v. Comprehensive Accounting Corp., 776 F.2d 665 (7th Cir. 1985)	10, 14, 16
Wilson v. Mobil Oil Corp., __ F. Supp. __, 1997 WL 675326 (E.D. La. Nov. 18, 1997)	10
Wilson v. Mobil Oil Corp., 940 F. Supp. 944 (E.D. La. 1996)	10

Citations

Page

Rule Cited:

Fed. R. Civ. P. 12(b)(6) 11

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Respondent Domino's Pizza, Inc. ("DPI") respectfully requests that this Court deny the petition for writ of certiorari to the United States Court of Appeals for the Third Circuit.

STATEMENT OF THE CASE

A. Factual Background[1]

DPI is a retail food service company that sells pizza and other fast food products through more than 4,000 stores displaying DPI's "Domino's" trademark. Pet. App. 3, 52. Petitioners comprise 11 franchisees who operate 58 of the approximately 3,500 Domino's stores owned by franchisees. Pet. App. 77-81.

Each of the petitioners joined the Domino's system by executing a standard franchise agreement with DPI. Pet. App. 3. Under these contracts, petitioners agreed, in return for entry into the Domino's system, to follow uniform practices and procedures specified by DPI with respect to numerous aspects of Domino's pizza store operations. Pet. App. 4, 52-54. The franchise agreements provide that DPI

> may in [its] sole discretion require that ingredients, supplies and materials used in the preparation, packaging, and delivery of pizza be purchased exclusively from us or from approved suppliers or distributors.

Pet. App. 4.

The franchise agreements also grant DPI the right to impose "reasonable limitations on the number of approved suppliers or

1. The following summary is based on petitioners' factual allegations, which respondent assumes to be true solely for purposes of opposing the petition.

distributors of any product." *Id.* Significantly, DPI's rights are subject to a reasonableness clause providing that DPI must "exercise reasonable judgment with respect to all determinations to be made by [DPI] under the terms of this Agreement." *Id.*

International Franchise Advisory Council ("IFAC") is an organization whose members include approximately 40% of the Domino's franchises in the United States. Pet. App. 5. In 1994, IFAC entered into a purchasing agreement with Food Service Purchasing Cooperative, Inc. ("FPC"), which acts as purchasing agent for franchisees of retail level competitors of the Domino's system such as Kentucky Fried Chicken and Taco Bell. Pet. App. 6, 86. Under the purchasing agreement, FPC was charged with developing a purchasing program for Domino's franchisees who desire to purchase pizza supplies and ingredients from sources other than the distribution system operated by DPI. Pet. App. 6. FPC is not a party to this proceeding and was not a party below.

Petitioners claim that DPI has breached its express contract obligations to Domino's franchisees by imposing unreasonable policies and procedures designed to interfere with the purchasing agreement and thereby unreasonably to prevent FPC from developing an alternative distribution service. Pet. App. 6-7, 55-56, 106-07. According to petitioners, DPI's actions contravene their franchise agreements in that the actions do not advance the recognized, joint interests of DPI and its franchisees in maintaining consistency and quality throughout the Domino's system. Pet. App. 86, 96. Petitioners do not allege that, apart from its rights under the franchise agreements, DPI exercises any independent control or market power in any market for pizza ingredients such as cheese, sauce, dough or meats, or any other supply used in Domino's stores. Nor do petitioners assert that such products are so unique that DPI alone can control their supply. Instead, petitioners maintain that DPI's contractual

rights reasonably to restrict ingredients purchases, approve suppliers and otherwise regulate franchisee store operations create "market power" and permit the definition of relevant antitrust markets limited just to Domino's franchisees. *See* Pet. App. 103-05.

B. Proceedings Below

In an amended complaint filed in the United States District Court for the Eastern District of Pennsylvania, petitioners alleged that DPI's actions relating to the supply of ingredients and supplies to Domino's stores: (i) violated the federal antitrust laws; (ii) breached DPI's franchise agreements; and (iii) tortiously interfered with the purchasing agreement between IFAC and FPC. The District Court dismissed the antitrust claims with prejudice for failure to state a claim, and dismissed the supplemental contract and tort claims for lack of subject matter jurisdiction. Pet. App. 51-69. Petitioners moved for leave to file a second amended complaint setting forth essentially the same antitrust and common law claims; the District Court denied this motion. Pet. App. 70-75.

The United States Court of Appeals for the Third Circuit affirmed the District Court's dismissal of petitioners' action, principally on the ground that petitioners' alleged "relevant markets" — ingredients and supplies approved for use by Domino's stores — are legally insufficient. Pet. App. 16. Relying on *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 482 (1992), among other cases, the Third Circuit reasoned that "the outer boundaries of a relevant market are determined by reasonable interchangeability of use." Pet. App. 14; *see id.* at 18. In assessing interchangeability, the Third Circuit stated,

> the relevant inquiry . . . is not whether a Domino's franchisee may reasonably use both approved or non-

> approved products interchangeably *without triggering liability for breach of contract*, but whether pizza makers in general might use such products interchangeably.

Pet. App. 17 (emphasis added).

Because there is no dispute that, contractual constraints aside, approved supplies are interchangeable with non-approved supplies, *see* Pet. App. 17, 18, "the relevant market . . . cannot be restricted solely to those products currently approved by [DPI]." Pet. App. 16. Judge Lay dissented. The Third Circuit subsequently denied petitioners' petition for rehearing *en banc*.

REASONS FOR DENYING THE WRIT

The Third Circuit properly refused to convert a contract dispute arising under a franchise agreement into an antitrust action.

I.

THE THIRD CIRCUIT'S DECISION IS IN ACCORD WITH *KODAK*.

Although petitioners argue that their antitrust claims "plainly parallel" the allegations upheld in *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992), Pet. 16-17, that is not the case. *Kodak* focused on potential harm to consumers — not franchisees — in a relevant market that arose out of the uniqueness of Kodak parts and that had nothing to do with any contract between Kodak and its customers. Indeed, there was no contract. Here, it is "uncontroverted that Domino's-approved supplies and ingredients are fully interchangeable in all relevant respects with other pizza supplies outside the proposed relevant market." Pet. App. 20-21.

The markets alleged by petitioners are grounded exclusively on the obligations of Domino's franchisees under their franchise contracts with DPI, not lack of interchangeability. As *Kodak* instructs, "market definition . . . . can be determined only after a factual inquiry into the 'commercial realities' faced by consumers." 504 U.S. at 482 (citations omitted) (emphasis added). The only "commercial realities" alleged by petitioners are those faced not by consumers of pizzas but by allegedly mistreated franchisees within the contractually defined framework of the Domino's system.[2]

In stark contrast, the antitrust claims upheld in *Kodak* were based, not on contract obligations, but on alleged single-brand product markets consisting of service and unique parts for Kodak copiers. In the absence of a contract affording a remedy to consumers that had purchased its copiers, Kodak initiated a policy of refusing to supply highly specialized replacement parts to independent service organizations, thereby forcing owners of its machines to use only Kodak's service system. The Court held that a relevant market limited to Kodak products was appropriate "[b]ecause service and parts for Kodak equipment are not interchangeable with other manufacturers' service and parts." 504 U.S. at 481-82. Because copier owners had no way of predicting Kodak's policy change and could switch out of Kodak copiers only at significant cost, the Court ruled that they were potentially "locked in" to "aftermarkets" for specialized

2. The goal of the Sherman Act "is not to protect businesses from the workings of the market; it is to protect the public from the failure of the market." *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458 (1993); *see also State Oil Co. v. Khan*, __ U.S. __, 118 S. Ct. 275, 277, 282 (1997) ("the primary purpose of the antitrust laws is to protect interbrand competition") (overruling *Albrecht v. Herald Co.*, 390 U.S. 145, 152-54 (1968)); *Grappone Inc. v. Subaru of New England, Inc.*, 858 F.2d 792, 794 (1st Cir. 1988) (antitrust laws exist to "protect the competitive process in order to help individual consumers") (Breyer, J.).

Kodak parts and service. As a result, Kodak may have possessed "market power" (not contract rights) in an aftermarket for Kodak parts, notwithstanding that the primary market for all copier brands was itself competitive. *See* 504 U.S. at 465-66, 477-78.

Here, the Domino's franchisees did not invest in an expensive and complex piece of machinery. They joined a business enterprise by entering into franchise agreements. Petitioners are allegedly "locked in" to "aftermarkets" for pizza supplies approved by DPI not because pizza ingredients are unique but *only* by virtue of their franchise agreements. Pet. App. 22-23. Whereas the consumers and service providers in *Kodak* had no recourse — other than the antitrust laws — the franchisees in this case are parties to binding contracts that govern the subject matter of this dispute and that clearly provided notice of DPI's right to approve suppliers. Pet. App. 32, 64; *see also Digital Equip. Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756, 763 (7th Cir. 1996) ("The Court did not doubt in *Kodak* that if spare parts had been bundled with Kodak's copiers from the outset . . . purchasers could have shopped around for competitive life-cycle prices.").[3]

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3. Petitioners cite *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968) — which was overruled on other grounds by *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984) — apparently for the proposition that an antitrust violation cannot be defended on the ground that it is embodied in a franchise contract. Pet. 10. While it is true that a defendant cannot avoid antitrust liability simply because the plaintiff agreed to the alleged violation, *Perma Life* says nothing about whether a relevant market can be defined by the terms of a franchise or other contract.

Nor does the decision in *Standard Oil Co. v. United States*, 337 U.S. 293 (1949) — a case evaluating requirements contracts rather than tying arrangements — support petitioners' claims. As Justice O'Connor recognized in *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*,

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Petitioners further assert that, like Kodak, DPI has instituted new and unreasonable policies of which Domino's franchisees were unaware when they entered into Domino's franchise agreements. Pet. 16-18. But petitioners do not deny — indeed they allege — that they retain their contract rights and remedies against unreasonable behavior by DPI. The antitrust laws were certainly not intended to transform the law of contracts by using contractual obligations to define a series of "markets" in which one party to the bargain exercises contract-driven "monopoly power" over the other.[4] Antitrust policy simply is not concerned with "restrictions on the autonomy of independent businessmen." *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 53 n.21 (1977).

In *Kodak*, the Court refused to accept *a priori* conclusions about the extent to which conduct harmful to "locked-in"

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466 U.S. 2 (1984), *Standard Oil*'s dicta concerning tying arrangements were "not taken literally even by the cases that purported to rely upon it." 466 U.S. at 34 (O'Connor, J., concurring).

4. *See* Benjamin Klein, *Market Power in Antitrust: Economic Analysis After Kodak*, 3 Sup. Ct. Econ. Rev. 43, 62 (1993) ("Instead of finding 'monopolies' everywhere, 'hold-up' problems should be left to contract law.").

Petitioners allege that they lacked notice of DPI's control of the supplier-approval process, notwithstanding that the franchise agreements expressly reserve DPI's right to require that supplies and ingredients be purchased from DPI-approved suppliers or from DPI itself. Pet. App. 97-98; *see id.* 129-30. Even if there were a question as to notice, petitioners' allegations based on Domino's-only relevant markets would still fail to state a claim. The overriding flaw in petitioners' antitrust theory is not that franchisees had notice of Domino's right to approve suppliers but rather that the only "power" DPI allegedly exercises over its franchisees arises out of contractual arrangements that afford common law remedies for breach.

consumers in aftermarkets (for copier servicing and parts) is necessarily precluded by the existence of competition in a related pre-market (for the copiers themselves). *See* 504 U.S. at 469-70. The decision below does not rest on a comparable factual assumption as to whether competition in other markets curbs harmful conduct in the supposed "aftermarkets" for pizza supplies and ingredients used in Domino's stores. Instead, the court of appeals addressed the *legal* issue of whether Domino's-only "aftermarkets" arising out of the Domino's franchise agreements — not the attributes of any supply or ingredient sold in those supposed markets — may comprise relevant markets for purposes of antitrust analysis. Pet. App. 12-13, 16-18. This question does not turn on product attributes, consumer preferences, cross-elasticity of demand, or any other factual issue. It is a pure question of law.

II.

THERE IS NO CONFLICT AMONG THE CIRCUITS.

Despite the petition's suggestions to the contrary, there is no conflict among the courts of appeals on the question presented. Instead, the Third Circuit's decision is in harmony with the decisions of all of the courts of appeals to have considered similar attempts "to shoehorn [antitrust] allegations into [the] *Kodak* 'derivative aftermarket' mold." *Lee v. Life Ins. Co. of North America*, 23 F.3d 14, 17 (1st Cir.), *cert. denied*, 513 U.S. 964 (1994). *See Valley Prods. Co., Inc. v. Landmark*, 128 F.3d 398, 405-07 (6th Cir. 1997); *United Farmers Agents Ass'n v. Farmers Ins. Exchange*, 89 F.3d 233, 236-37 (5th Cir. 1996), *cert. denied*, __ U.S. __, 117 S. Ct. 960 (1997).[5]

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5. Notably, the Court denied petitions for certiorari in the two of these three post-*Kodak* cases in which petitions were filed. *See also PSI Repair Servs., Inc. v. Honeywell, Inc.*, 104 F.3d 811, 819-21 (6th Cir.), *cert. denied*, __ U.S. __, 117 S. Ct. 2434 (1997).

The Fifth Circuit

In *United Farmers Agents*, the Fifth Circuit expressly recognized that an alleged "lock in" of a franchisee arising out of a franchise agreement cannot form the basis for a single-brand relevant market under *Kodak*. In that case, insurance agents brought antitrust claims against an insurance group with which they were affiliated. The agents claimed that the group had forced them to purchase computer equipment as a condition to obtaining access to a policy information data base. Relying on *Kodak*, the agents argued that high information and switching costs caused them to be "locked in" to a supposed "market" limited to the group's policy information. The Fifth Circuit expressly rejected this theory as a matter of law:

> This suit is essentially an intracompany dispute over how to run a computer system, not a valid claim under antitrust laws. Economic power derived from contractual agreements such as franchises or in this case, the agents' contract with [the insurance companies], "has nothing to do with market power, ultimate consumers' welfare, or antitrust". Benjamin Klein & Lester F. Saft, The Law and Economics of Franchise Tying Contracts, 28 J. Law & Econ. 345, 356 (1985).

89 F.3d at 236-37.[6]

6. Contrary to petitioners' dismissive characterization, Pet. 13, the Klein & Saft article cited by the Fifth Circuit is an influential piece of scholarship that has been favorably cited by numerous courts, as well as (in dissent) by three Members of this Court. *See Kodak*, 504 U.S. at 491 (Scalia, J., dissenting, joined by O'Connor, J. and Thomas, J.); Pet. App. 23 n.12 (opinion below); *United Farmers Agents*, 89 F.3d at 236-37; *Chicago Prof'l Sports L.P. v. NBA*, 95 F.3d 593, 598 (7th Cir. 1996); *Mozart Co. v. Mercedes-Benz of North*

(Cont'd)

Inexplicably, petitioners do not discuss — or even cite — *United Farmers Agents* in their petition, even though the court below relied on that decision. Pet. App. 17. Instead, petitioners emphasize the Fifth Circuit's much earlier decision in *Heatransfer Corp. v. Volkswagenwerk, A.G.*, 553 F.2d 964 (5th Cir. 1977). Like other time-worn cases cited in the petition, *see* Pet. 11-12 n.9, *Heatransfer* involved allegations that a franchisor had exercised power within a very narrowly defined market, in that case "the manufacture and sale of air-conditioners for only Volkswagen, Porsche and Audi automobiles." *Id.* at 979-81; *see also Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704, 712-14 (7th Cir. 1979) (franchisor had market power in the "drive-through retail photo processing submarket"). *Heatransfer* and the similar cases cited by petitioners have nothing to do with lock-ins, aftermarkets, information costs, or any other aspect of the *Kodak* framework, nor did they involve single-brand "markets" allegedly arising out of franchise agreements. Though based on doubtful economic assumptions, those decisions at

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America, Inc., 833 F.2d 1342, 1346 (9th Cir. 1987); *Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 671 n.1 (7th Cir. 1985); *Tominaga v. Shepherd*, 682 F. Supp. 1489, 1493-95 (C.D. Cal. 1988); *see also New Jersey American, Inc. v. The Allied Corp.*, 875 F.2d 58, 62 (3rd Cir. 1989) (citing Klein & Saft article in ruling on claims under the New Jersey Franchise Practices Act).

In *Wilson v. Mobil Oil Corporation*, another lawsuit in the Fifth Circuit alleging tying by a franchisor, the district court denied the defendants' motion to dismiss, strongly disagreeing with the decision of the district court below. *See* 940 F. Supp. 944, 951-52 (E.D. La. 1996). One year later, however, the *Mobil Oil* district court essentially reversed itself, granting the defendants summary judgment based in part upon the decision of the court of appeals in this case. *See* __ F. Supp. __, 1997 WL 675326 at *11 (E.D. La. Nov. 18, 1997). The petition cites the first *Mobil Oil* decision but fails to mention the second.

least focused on an alleged relevant product's purported lack of interchangeability. They lend no support to petitioners' antitrust theories, nor do they represent any part of a purported split among the courts of appeals on these issues. *See United Farmers*, 89 F.3d at 236-37 (5th Cir.); *see also Digital Equip. Corp. v. Uniq Digital Techs., Inc.*, 73 F.3d 756, 762-63 (7th Cir. 1996) (rejecting distributor's *Kodak*-based antitrust tying claims where defendant manufacturer lacks power in highly competitive market for mid-range computers).

The Sixth Circuit

Since the Fifth Circuit's decision in *United Farmers*, the Sixth Circuit similarly has rejected an attempt to conform an alleged tying claim arising in the franchise context to the unique circumstances at issue in *Kodak*. *See Valley Prods*, 128 F.3d 398 (6th Cir. 1997). The plaintiff in *Valley Products* was a terminated supplier of soap and other amenities to hotel franchisees who alleged that the franchisees were illegally coerced into purchasing other suppliers' amenities as a condition to their franchise rights. In affirming a Rule 12(b)(6) dismissal, the Sixth Circuit rejected the plaintiff's attempt to model its tying claim on a *Kodak* "lock-in" theory. In the course of its opinion, the court expressly endorsed the reasoning of the opinion below, finding that the Third Circuit's holding supported dismissal of the supplier's tying claim. *See Valley Products* 128 F.3d at 405 ("[w]e are in basic agreement in the approach followed in *Domino's*"); *see also id.* at 407.

The Sixth Circuit's endorsement of the rationale of the opinion below belies petitioners' assertion of a divergence between the Third and Sixth Circuits. In suggesting that there is a divergence, petitioners cite *PSI Repair Services, Inc. v. Honeywell, Inc.*, 104 F.3d 811 (6th Cir.), *cert. denied*, __ U.S. __, 117 S. Ct. 2434 (1997), in which the Sixth Circuit expressly rejected another *Kodak*

tying claim that did not concern contract rights. The *PSI* decision is in no sense inconsistent with the decision below.

In *PSI*, an independent repair service for industrial control equipment alleged an illegal tying arrangement between Honeywell-brand circuit board components and servicing of Honeywell circuit boards. *See* 104 F.3d at 818-20. The Sixth Circuit affirmed summary judgment dismissing this claim, finding that the plaintiff's argument

> would expose many manufacturers of durable, expensive equipment to potential antitrust liability for having inherent power over the aftermarkets of their products, a result certainly not intended by *Kodak* and not consistent with *Jefferson Parish.*

Id. at 820.[7]

Nor is the *Valley Products* decision, following the court of appeals below, at odds with the earlier decision of the Sixth Circuit denying summary judgment in *Virtual Maintenance, Inc. v. Prime Computer, Inc.*, 11 F.3d 660 (6th Cir. 1993), *cert. dismissed*, 512 U.S. 1216 (1994). The potential "market power" in that case derived from a requirement imposed by Ford Motor Company — a non-party — that all of its outside designers use specified software. The defendant distributor, a Ford licensee, was accused of improperly leveraging Ford's requirement by

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7. The basis for petitioners' argument appears to be that the court below did not ascribe the same significance as the Sixth and Seventh Circuits to the "change in policy" that was discussed by the *Kodak* majority in reaching its determination in that case. Pet. 21-24. This argument misses the essential point that in neither *Kodak* nor any of the other cases relied on by petitioners did the plaintiff allege a relevant market grounded in a contractual arrangement, and that in none of those cases did such a contract provide remedies for the misconduct alleged.

conditioning sales of the Ford-required software upon the designers' purchase of additional software support services. These circumstances are not comparable to those presented here because, among other things, the distributor and the designers were not parties to a contract affording them respective rights and remedies.

The First Circuit

Also consistent with the court of appeals decision below is the decision of the First Circuit in *Lee v. Life Insurance Co.* In *Lee*, university students alleged an illegal tying arrangement between their university education and health insurance, contending that they were subject to a *Kodak* "lock-in" after matriculation in their first semester. The First Circuit rejected this theory and affirmed the dismissal of the complaint for failure to state a claim, in part because subsequent semesters of undergraduate education could not be construed to be a "derivative aftermarket" under *Kodak*. *Lee*, 23 F.3d at 19-20.

The *Lee* decision logically followed from *Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792 (1st Cir. 1988) (Breyer, J.), a pre-*Kodak* opinion that is squarely in accord with the Third Circuit's decision below. *Grappone* analyzed tying claims by Subaru franchisees challenging Subaru's policy of conditioning the delivery of new cars upon the purchase of spare parts. The First Circuit concluded that the arrangement did not violate Section 1 of the Sherman Act, finding that the attractiveness of the Subaru brand could not give rise to the type of market power required to prevail on such a claim. *Grappone*, 858 F.2d at 796-97, 798 (citing *United States Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610, 620-21 (1977) ("*Fortner II*")).

The Ninth Circuit

In *Mozart Co. v. Mercedes-Benz of North America, Inc.*, 833 F.2d 1342, 1346 (9th Cir. 1987), the Ninth Circuit followed similar reasoning. Like *Grappone*, *Mozart* involved a challenge to a car manufacturer's policy of requiring franchised dealers to sell only replacement parts that were supplied or approved by the manufacturer. The district court's jury instructions had implied that the market power necessary for plaintiff's tying claims could be proven from the attractiveness of the car maker's trademark or the uniqueness of the automobile. The Ninth Circuit held that such a conclusion was unwarranted, especially in the franchise context:

> To [franchisees the Mercedes] is an article that is purchased at wholesale and sold at retail. The critical issue is whether [Mercedes Benz] possesses the "market power" to force dealers to purchase the tied product rather than acquire the franchise to sell a different automobile. Obviously there are costs in surrendering one franchise and acquiring another, but these are costs unrelated to the "market power" of a unique automobile. . . . this power is related to the franchise method of doing business, not to the possible uniqueness of the car.

Mozart, 833 F.2d at 1346-47.[8]

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8. This holding overruled the rationale of *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43 (9th Cir. 1971) ("distinctive" trademark held to afford fast-food franchisor market power). *See also Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 671 n.1 (7th Cir. 1985). To the extent that petitioners imply that *Siegel* represents one side of a split among the courts of appeals, *see* Pet. 11-12 & n.9, that suggestion is simply wrong. The pre-*Fortner II* decision of the Eighth

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Petitioners assert that "*Kodak* vitiated *Mozart*'s rationale," because *Kodak* held that the existence of competition in the primary market for copiers did not undermine as a matter of law the plaintiff's "derivative aftermarket" claims. Pet. 14-15. As discussed above, however, petitioners' "derivative aftermarket" allegations were not dismissed because competition in the market for business franchises — the primary market — constrains DPI's power in the supposed "aftermarkets" for supplies and ingredients used in Domino's stores. Although that is the case, petitioners' allegations were found by the lower courts to fail as a matter of law because relevant markets under the antitrust laws cannot be based on "power" arising out of franchise agreements, as opposed to the intrinsic attributes of the supplies and ingredients sold in the alleged Domino's-only "markets".

The Fourth Circuit

Petitioners mistakenly rely on the Fourth Circuit decision in *Metrix Warehouse, Inc. v. Daimler-Benz Aktiengesellschaft*, 828 F.2d 1033 (4th Cir. 1987), a case that involved an earlier challenge to the same Mercedes-Benz policy at issue in *Mozart*. Petitioners' arguments aside, the Fourth Circuit in *Metrix* never addressed the crucial question — definition of the relevant market for the tying product — instead limiting itself to the narrow question whether this Court's decision in *Pick Mfg. Co.*

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Circuit in *Northern v. McGraw-Edison Co.*, 542 F.2d 1336, 1345 (8th Cir. 1976), also cited in the petition, was based upon a similar, outdated view that market power could arise from the attractiveness or uniqueness of a franchise trademark. *See also Collins v. International Dairy Queen, Inc.*, 939 F. Supp. 875, 880 (M.D. Ga. 1996) (summary judgment denied where plaintiff's expert opines that relevant market may be limited to "soft-serve ice cream franchises").

v. General Motors Corp., 80 F.2d 641 (7th Cir. 1935), *aff'd*, 299 U.S. 3 (1936) (per curiam), established an automobile industry exception for tying claims under the Sherman Act. *See Metrix*, 828 F.2d at 1036. The *Metrix* court expressly stated that the determination of this issue did not require it to decide whether the plaintiff had proved the requisite elements of an illegal tying arrangement, which would include definition of a relevant market. *Id.*

The Seventh Circuit

Petitioners' suggestion that the decision below conflicts with precedent in the Seventh Circuit is also unsupportable. In *Digital Equipment Corp. v. Uniq Digital Technologies*, 73 F.3d 756 (7th Cir. 1996), that court confronted and rejected an attempt similar to petitioners' to contort a "mundane commercial case" into a *Kodak* tying claim. *See Digital*, 73 F.3d at 763. In that case, Digital Computer replaced the Uniq operating system with a Unix system of its own, prompting antitrust claims from its disappointed rival alleging that Digital's policy of including its own operating system in Digital computers was an illegal tying arrangement. The court rejected Uniq's contention that under *Kodak* "there is a market in a firm's own products, even if it sells in vigorous competition," *id.* at 762, and affirmed the dismissal of the claim. And, well before *Digital*, the Seventh Circuit observed: "A tie involves products that may be sold in separate markets. But a method of doing business (the franchise) is not sold separately from the ingredients that go into the method of business." *Will v. Comprehensive Accounting Corp.*, 776 F.2d 665, 671 n.1 (7th Cir. 1985).

* * *

In short, the decision below is in accord with all the court of appeals decisions that have considered "derivative

aftermarket" claims since *Kodak*, as well as a variety of pre-*Kodak* franchise-antitrust decisions. Given the absence of conflict among the courts of appeals concerning the question presented and the sound reasoning of the Third Circuit below, the petition should be denied.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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Supreme Court, U.S.
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No. 97-1134

In the
Supreme Court of the United States
October Term, 1997

BAUGHANS, INC.; BLUE EARTH ENTERPRISES, INC.; KEVIN BORES; CHARLES F. BUCK; DAVIS PIZZA ENTERPRISES, INC.; DIANE A, DAVIS; FISHER PIZZA, INC.; JAMES B. FISHER, JR.; JRW PIZZA, INC.; LUGENT PIZZA, INC.; JOSEPH J. LUGENT; SCALE PIZZA, INC.; SPRING GARDEN PIZZA, INC.; BRAD L. WALKER; JAMES R. WOOD; INTERNATIONAL FRANCHISE ADVISORY COUNCIL, INC.,

Petitioners,

v.

DOMINO'S PIZZA, INC.

Respondent.

On Petition For A Writ Of Certiorari To The United States Court of Appeals for the Third Circuit

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PETITIONERS' REPLY BRIEF

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APP

ARGUMENT

Refuting a strawman argument rather than responding to the Franchisees' antitrust claims, Domino's says:

> Petitioners do not allege that, apart from its rights under the franchise agreements, DPI exercises any independent control or market power in any market for pizza ingredients such as cheese, sauce, dough or meats, or any other supply used in Domino's stores. . . . Instead, petitioners maintain that DPI's contractual rights reasonably to restrict ingredients purchases, approve suppliers and otherwise regulate franchisee store operations create "market power" and permit the definition of relevant antitrust markets limited just to Domino's franchisees. *See* Pet. App. 103-105.

Brief in Opposition 2-3. That assertion completely mischaracterizes the Franchisees' antitrust claims, in an obvious effort to obfuscate the split in circuits in franchisee antitrust cases.

The Franchisees' complaint alleged that Domino's used its 90% share of the $500,000 ingredients and supplies aftermarket — not its contractual approval prerogatives — to exclude the franchisee cooperative from becoming a competitor in that market. Domino's used predatory prices to induce franchisees into exclusive dealing arrangements to foreclose the cooperative's potential customers, and used its market power to coerce suppliers into requirements contracts, foreclosing the cooperative's potential suppliers. This anticompetitive behavior was in stark contrast to Domino's promise of an aftermarket policed by price competition, and Domino's change in policy occurred after the Franchisees' sunk costs locked them into their franchises.

In addition to misstating the Franchisees' antitrust claims, Domino's also misstates the holding in *United Farmers Agents*

Assoc. Inc. v. Farmers Insurance Exchange, 89 F.3d 233 (5th Cir. 1996). Domino's states: "In *United Farmers Agents*, the Fifth Circuit expressly recognized that an alleged 'lock in' of a **franchisee** arising out of a **franchise agreement** cannot form the basis for a relevant market under Kodak." Brief in Opposition 9 (emphasis supplied). But, *United Farmers Agents* involved insurance agents, not business format franchisees. The Fifth Circuit actually held that the ease with which insurance agents can sell insurance for other companies rendered *Kodak's* lock-in analysis inapplicable on the facts of that case. 89 F.3d at 238-39.

Domino's also misstates the holding in *Metrix Warehouse, Inc. v. Daimler-Benz Aktiengesselschaft*, 828 F.2d 1033 (4th Cir. 1987). Domino's states that, in *Metrix*, the Fourth Circuit was "limiting itself to the narrow question whether this Court's decision in *Pick Mfg. Co. v. General Motors Corp.*, 80 F.2d 641 (7th Cir. 1935), *aff'd*, 299 U.S. 3 (1936) (per curiam) established an automobile industry exception for tying claims under the Sherman Act." Brief in Opposition 15-16. However, the Fourth Circuit addressed not only that issue, but also the jury's rejection of Mercedes' proffered business justification for its tying arrangement. 828 F.2d at 1040-42. *Metrix*, 828 F.2d at 1040-43. The Fourth Circuit's decision directly conflicts with the Ninth Circuit's decision in *Mozart Co. v. Mercedes-Benz of N. Am.*, 833 F.2d 1342 (9th Cir. 1987), *cert. denied*, 488 U.S. 870 (1988), that the aftermarket for replacement parts is not a cognizable antitrust market. Even Domino's concedes the Fourth Circuit decision involved "the same Mercedes-Benz policy at issue in *Mozart*." Brief in Opposition 15.

As the Petition demonstrates, there is a clear split in the Circuits in franchise tying cases.[1] *See* Petition 11-15. Indeed, this

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[1]*Compare Metrix Warehouse, Inc. v. Daimler-Benz Aktiengesselschasft*, 828 F.2d 1033 (4th Cir. 1987); *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704 (7th Cir. 1979), *cert. denied*, 445 U.S. 917 (1980); *Heatransfer Corp. v.*

case presents one of the most hotly debated issues in current antitrust commentary. *See* Petition 5 n.2. The Petition should be granted to resolve that debate.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be granted.

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Volkswagenwerk A.G., 553 F.2d 964 (5th Cir. 1977); *Northern v. McGraw-Edison Co.*, 542 F.2d 1336 (8th Cir. 1976), *cert. denied*, 429 U.S. 1097 (1976) *with Valley Prods. Co., Inc. v. Landmark*, 128 F.3d 398 (6th Cir. 1997); *Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792 (1st Cir. 1988); *Mozart Co. v. Mercedes-Benz of N. Am., Inc.*, 833 F.2d 1342 (9th Cir. 1987).